

Employee Benefit ■ Plan Review

ERISA Does Not Preempt Certain State Law Claims Against “Dual-Hat” Officers and Directors, Appellate Court Rules

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In *Halperin v. Richards*,¹ the U.S. Court of Appeals for the Seventh Circuit considered whether the Employee Retirement Income Security Act of 1974 (“ERISA”) preempted certain state law corporate liability claims against officers and directors of Appvion Inc., who also served as ERISA fiduciaries with respect to Appvion’s Employee Stock Ownership Plan (“ESOP”). The court also considered whether ERISA preempted aiding and abetting breach of corporate fiduciary duty claims against the institutional ESOP trustee and its financial advisor.

The plaintiffs, co-trustees of the Appvion Liquidating Trust established in connection with Appvion’s bankruptcy proceedings, claimed that Appvion had been in financial decline for several years but that the defendants allegedly inflated the company’s stock value to increase the compensation paid to corporate directors and officers, whose pay was tied to the ESOP valuations, in violation of their fiduciary duties to the company under state law. The complaint asserted state law claims against Appvion’s officers and directors for various breaches of fiduciary duties, violations of state statutes and violations of bankruptcy statutes. The plaintiffs also asserted state law claims

for aiding and abetting breaches of fiduciary duties against the ESOP trustee and its financial advisor.

In its opinion issued on July 28, 2021, the court focused on the fiduciary duty claims against all the parties, but drew a significant distinction between the (1) “dual hat” fiduciaries, the officers and directors who serve dual roles as both corporate and ERISA fiduciaries and owe sometimes conflicting duties to the corporation and to the plan participants and beneficiaries, and (2) “single hat” fiduciaries, such as the trustee, whose actions were governed solely by ERISA and who does not owe fiduciary duties to the corporation under state law.

ERISA DOES NOT PREEMPT CORPORATE BREACH OF FIDUCIARY DUTY CLAIMS AGAINST OFFICERS AND DIRECTORS WHO SERVE DUAL ROLES

The court explained that as a director, an individual owes a duty under state law to the company’s shareholders, including the ESOP; however, as an ERISA fiduciary, the director owes a parallel but independent duty under ERISA to the ESOP and its beneficiaries. The

court reasoned that these duties must be parallel, as state law cannot require what ERISA prohibits, so “the fact that the directors’ and officers’ corporation-law and ERISA duties both prohibit the fraudulent conduct alleged by the plaintiffs is crucial.” The court further reasoned that ERISA invites the specific parallel and independent fiduciary duties at issue in the case. As such, the court found that ERISA does not preempt the state law claims at issue in this case.

In its determination that the state law claims against the officers and directors were not preempted, the court addressed four primary issues:

- (1) The plaintiffs’ inability to sue under ERISA;
- (2) The background of the exclusive benefit rule;
- (3) The exception to the exclusive benefit rule for officer and director liability; and
- (4) The ramifications of preemption.

First, the court addressed whether the plaintiffs were attempting to circumvent ERISA by asserting state law claims. The court noted that only participants, beneficiaries or fiduciaries are permitted to sue under ERISA. Because the plaintiffs were not ESOP participants, beneficiaries or fiduciaries, they had no standing to sue the officers and directors under ERISA. Thus, the plaintiffs could not have asserted ERISA claims or availed themselves of any ERISA remedies. The court found that this fact weighed against preemption.

Second, although the plaintiffs did not have standing to assert ERISA claims, their state law claims could still be preempted if the claims governed a central matter of plan administration or interfered with such administration under ERISA’s exclusive benefit rule. Under the exclusive benefit rule, an ERISA fiduciary must discharge its duties with respect to a plan solely in the interest of participants and beneficiaries, and

those duties are the “highest known to the law.” The court explained that because of the exclusive benefit rule (which, among other things, incorporates a duty of loyalty), it was skeptical of any state law efforts to add potentially conflicting duties, but recognized that ERISA nevertheless tolerates some measure of dual loyalty regarding officer and directors.

Third, the court thoroughly analyzed the exclusive benefit rule’s exception for dual-hat directors and officers. The court acknowledged the potentially “messy” conflicts of issue with respect to dual loyalties of directors who are also ERISA fiduciaries, and it cited a number of cases illustrating how courts have reconciled these differences.

Fourth, the court addressed the implications of potential ERISA preemption. It explained that if parallel liability under state law were preempted, then the directors would effectively cease to be corporate fiduciaries while wearing their ERISA fiduciary hats, and ERISA’s purpose to protect plan assets from misuse would be thwarted. In particular, the bankruptcy creditors in this case were unable to sue under ERISA; thus, if the state law claims were preempted, the plaintiffs would have no recourse at all for the alleged misconduct of directors and officers. The court also remarked that preemption of the plaintiffs’ claims would frustrate congressional intent by discouraging companies from forming ESOPs.

In its holding that the claims against the officers and directors were not preempted, the court reiterated that the director’s state law and ERISA duties will often run parallel to one another rather than in conflict with each other. Thus, duties to shareholders and duties to plan beneficiaries often involve the same conduct. Because the plaintiffs were “pursuing parallel corporation-law claims against dual-hat directors and officers . . . ERISA does not preempt those claims.”

ERISA DOES PREEMPT STATE LAW CLAIMS AGAINST “SINGLE-HAT” ERISA FIDUCIARIES, SUCH AS ESOP TRUSTEES OR THEIR ADVISORS

However, the court determined that ERISA did preempt the aiding and abetting breach of fiduciary claims against the trustee and its financial advisor. The court explained that the narrow exception to preemption for “dual-hat” officers and directors does not extend to “single-hat” ERISA fiduciaries, such as the ESOP trustee, because those fiduciaries do not owe a duty of loyalty to the company under state law.

With respect to the ESOP trustee, the court explained that the conflicts of interest inherent in a “dual-hat” officer or director do not extend to “single-hat” trustees, and that allowing aiding and abetting liability against the ESOP trustee would interfere with ERISA’s “single-minded focus on the plan and its beneficiaries” and “effectively force a second hat onto single-hat ERISA fiduciaries.” The key difference was that ERISA’s exclusive benefit rule preempts parallel state-law liability “outside the narrow and unavoidable exception for dual-hat directors and officers.” The court also noted that ERISA beneficiaries, participants and fiduciaries would be able to pursue remedies against the ESOP trustee under ERISA.

The court also held that ERISA’s exclusive benefit rule protected the ESOP trustee’s financial advisor from state law claims for aiding and abetting corporate breaches of fiduciary duty. The court likened the financial advisor to a “single-hat” provider retained by the ESOP trustee for its valuation expertise. Unlike the trustee, the financial advisor did not owe fiduciary duties under ERISA; however, the court concluded that the financial advisor was more similarly situated to the ESOP trustee than it was to the corporate officers and directors.

The court explained that:

- (1) To protect the trustee's single-minded focus on beneficiaries, it was also necessary to protect the trustee's financial advisor, whose involvement arose solely from the trustee's duties;
- (2) Parallel state liability to the corporation would conflict with ERISA's focus on protecting beneficiaries; and
- (3) State law liability for the financial advisor could create a conflict between a state law damages remedy and ERISA's remedial limits on claims against non-fiduciaries.

KEY CONSIDERATIONS

The court's decision reflects that disputes over ERISA preemption are alive and well. Claims against ERISA fiduciaries outside of ERISA's statutory scheme should be

scrutinized closely for preemption considerations.

TAKEAWAYS

- The U.S. Court of Appeals for the Seventh Circuit considered whether ERISA preempted certain state law corporate liability claims against officers and directors who also served as ERISA fiduciaries and whether ERISA preempted the same claims against an ERISA trustee and non-fiduciary service provider.
- The court determined that ERISA did not preempt the state law claims against the officers and directors, concluding that ERISA contemplates parallel state law corporate liability against directors and officers who serve dual roles as both corporate and ERISA fiduciaries.

- The court found that ERISA did preempt the state law claims against the employee benefit plan trustee and its financial advisor because those claims would interfere with ERISA's remedial scheme. 🌐

NOTE

1. <http://media.ca7.uscourts.gov/cgi-bin/rssExec.pl?Submit=Display&Path=Y2021/D07-28/C:20-2793;J:Hamilton.aut:T;fnOp:N:2740159:S:0>.

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