

Federal Court Denies ESOP Participant Claims for Breach of Fiduciary Duty

June 25, 2009

On May 20, the U.S. District Court for the Eastern District of Missouri, on a motion to dismiss, ruled that in order to succeed on a breach of fiduciary duty claim, the complaint must state that the defendant was acting in his capacity as a plan fiduciary when he engaged in the alleged misconduct.

In *Blankenship v. Chamberlain*, 2009 WL 1421201 (E.D. Mo. May 20, 2009), the court considered a complaint with five counts, including two claims for breach of fiduciary duty under ERISA (one for injunctive relief and one for monetary relief), a common law claim for breach of fiduciary duty, a claim under Missouri state law to remove the defendant as an officer of the company and a trustee of the ESOP, and a claim for an accounting.

In this case, a group of 16 participants in the Contemporary Carpet Contractors, Inc. Employee Stock Ownership Plan (ESOP), the company, and the ESOP filed a complaint against Thomas Chamberlain, the sole trustee and fiduciary of the ESOP. The ESOP is the sole shareholder of the company, holding all of its issued and outstanding stock. In addition to serving as the sole trustee of the ESOP, Thomas Chamberlain also serves as the company's chief executive officer (CEO), its president, and the chair of its board of directors. The claims asserted in the plaintiffs' complaint arose from allegations of mismanagement with respect to the company's assets and work force, a lack of a functioning board of directors, and a general cessation of company operations, all of which threatened the company's ability to continue as a going concern. It is in light of these allegations that the court reviewed the claims for breach of fiduciary duty under ERISA.

As to the two claims for breach of fiduciary duty under ERISA, the court said that in order to state a claim for breach of fiduciary duty under Section 404 of ERISA, a plaintiff "must allege that (1) defendants were fiduciaries of the plan who, (2) acting within their capacities as plan fiduciaries, (3) engaged in conduct constituting a breach of an ERISA fiduciary duty." The court noted that the plaintiffs failed to assert facts sufficient to satisfy the second element required to pursue a breach of fiduciary duty claim. The court further pointed out that failure to assert that the defendant was acting within his capacity as a plan fiduciary was particularly critical in this case as the defendant performed many roles at the company as he served as the CEO, president, and chair of the board of directors, in addition to serving as the trustee for the ESOP. Given the many roles played by the defendant, the court noted that "the defendant can only be liable for action he took or duties he breached while performing ERISA obligations." As a result, the court reasoned that "the relevant question is not whether an employer's action adversely affected a beneficiary's interest, but whether the employer was acting as a fiduciary when he took that action." In other words, the defendant can only be liable for actions he took or duties

he breached while performing ERISA obligations, even if actions taken while not performing ERISA obligations did tangentially harm a beneficiary's interest in an ERISA plan. Consequently, the court concluded that the breach of fiduciary duty claims fail to state a claim for which relief can be granted.

The three remaining counts in the complaint were all state law claims. As to these items, the court considered whether ERISA preempts Missouri law as it relates to this employee benefit plan. In doing so, the court analyzed the seven factors that have been identified by the Eighth Circuit: (1) whether the state law negates an ERISA plan provision, (2) whether the state law affects relations between primary ERISA entities, (3) whether the state law impacts the structure of ERISA plans, (4) whether the state law impacts the administration of ERISA plans, (5) whether the state law has an economic impact on ERISA plans, (6) whether preemption of the state law is consistent with other ERISA provisions, and (7) whether the state law is an exercise of traditional state power. After analyzing the counts in the complaint, the court concluded that the relief sought under the claims was preempted by ERISA. In doing so, the court specifically noted that the plaintiffs attempt to bring a state law claim for common law breach of fiduciary duty was preempted by ERISA, which provides specific fiduciary standards with respect to employee benefit plans. A state law claim for common law breach of fiduciary duty would not be permitted as an attempt to provide an avenue around the requirements for bringing an ERISA breach of fiduciary duty claim.

As a final point, the court noted that the ESOP did not have standing to bring this lawsuit because only the Secretary of the Treasury Department, a participant, a beneficiary, or a fiduciary can bring a lawsuit under Section 409 of ERISA. Because the ESOP trustee did not authorize this lawsuit, the ESOP was not authorized to bring these claims.

Although the motion to dismiss was granted, the court granted the ESOP participants leave to amend their complaint with regard to the breach of fiduciary duty claims. However, in granting the motion to dismiss, the court acknowledged that actions taken by an individual who happens to serve as an ERISA fiduciary but is not acting as an ERISA fiduciary in taking such actions do not support claims for a breach of fiduciary duty under ERISA. To succeed in a claim for a breach of fiduciary duty under ERISA, plaintiffs must assert, and then prove, that the actions adversely affecting the beneficiaries of an employee benefit plan were taken while the individual was performing as an ERISA fiduciary.

If you have any questions or would like further information on the ESOP issues discussed in this case, please contact any one of the following Morgan Lewis attorneys:

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