No. 10-3598

IN THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

SECRETARY OF LABOR,

Plaintiff-Appellant,

v.

CYNTHIA HOLLOWAY and JAMES DOYLE,

Defendants-Appellees.

On Appeal from the United States District Court for the
District of New Jersey

REPLY BRIEF OF THE SECRETARY OF LABOR

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REPLY BRIEF OF THE SECRETARY OF LABOR

I. THE EVIDENCE ESTABLISHES THAT HOLLOWAY BREACHED HER FIDUCIARY DUTIES AS TRUSTEE BY IMPRUDENTLY MANAGING THE FUND AND ENABLING OTHER FIDUCIARIES TO DIVERT ITS ASSETS

As the Secretary discussed in her opening brief, Holloway, who was a trustee and ERISA fiduciary charged with the highest standard of care in managing the operation of the Fund and protecting its assets, did little or nothing to ensure that the Fund could pay all its claims and that it maintained adequate financial and claims records. As we explained, the second of four companies that worked as plan administrators during the two years that the Fund operated informed Holloway in April and May of 2002 not only that there were unpaid claims and no adequate claims records, but also that the Fund could not pay all its claims and probably had not paid any since November of the previous year. Opening Brief of the Secretary of Labor (Sec'y Br.) at 16, citing JA 10, 12, 13. And the second to last administrator informed Holloway in September 2002 that PCI/North Point was not making its contributions. Holloway resigned later that month and, by her own admission, did so because of the "lack of financial accountability for contributions to the Fund and resultant lack of funding to pay claims," JA 14 (emphasis added), as well as the "issuance of cease and desist order by multiple states," id., that considered the entire scheme illegal under their insurance laws.

Despite this damning evidence, which Holloway dismisses as showing merely "some challenges in the administration of the Fund, disputes between Trustees, and concerns regarding the flow of information," Brief of Appellee Cynthia Holloway (Holloway Br.) at 24, Holloway insists she acted in accordance with her fiduciary duties because the Secretary: (1) did not prove that there were unpaid claims several months later when the Fund was closed down or establish the extent of such unpaid claims; (2) did not present evidence that PCI and North Point did not make their proper contributions; (3) did not show that the Fund paid any excessive fees; (4) did not show that Holloway, as opposed to the administrator, was required to make any additional inquiry such as performing an audit; (5) did not show that Holloway breached her duties by resigning under the circumstances; and (6) did not establish any breach of Holloway's duty as a co-fiduciary. We address each of these contentions in turn, and then explain how any issue surrounding the full extent of damages to the Fund is irrelevant to the question whether Holloway breached her duties as trustee to prudently manage the Fund, an issue that the district court failed to address.

1. Unpaid Claims

Although Holloway makes much of the fact that the Secretary was unable to offer record evidence or testimony proving the existence or extent of unpaid claims at the time the Fund ceased to operate, this inability was due to the shoddy or nonexistent recordkeeping by those who administered the Fund, a state of affairs that existed during the time that Holloway was trustee, and at the time Holloway resigned and that only worsened thereafter when the last of the Fund's administrator's resigned. JA 17. Rather than helping Holloway's case, this only bolsters the conclusion that Holloway breached her duties as a Fund trustee when she left the Fund in such a state of affairs. As this Court has long recognized, "[t]here is no more fundamental duty imposed on those who hold property for others than that of rendering an account of its management." In re Pittsburgh Rys. Co., 117 F.2d 1007, 1008 (3d Cir. 1941) (debtor in possession). See also Landis v. Scott, 32 Pa. (8 Casey) 495, 502-03 (Pa. 1859) ("The duty of a trustee . . . to keep regular and correct accounts, is imperative. If he does not, every presumption of fact is against him. He cannot impose upon his principal . . . the obligation to prove [w]hat he has actually received. . . . By failing to keep and submit accounts, he assumes the burden of repelling the presumption and disproving negligence and faithlessness.").

In the ERISA context, this means that once the plaintiff "has proved a breach of fiduciary duty and a prima facie case of loss to the plan or ill-gotten profit to the fiduciary, the burden of persuasion shifts to the fiduciary to prove that the loss was not caused by, or his profit was not attributable to, the breach of duty." Martin v. Feilen, 965 F.2d 660, 671-72 (8th Cir. 1992) (citing George G. Bogert & George T. Bogert, The Law of Trusts and Trustees § 871 (2d revised ed. 1982 & Supp.1991)); accord McDonald v. Provident Indem. Life Ins. Co., 60 F.3d 234, 237 (5th Cir. 1995); Kim v. Fujikawa, 871 F.2d 1427, 1430-31 (9th Cir. 1989); Donovan v. Bierwirth, 754 F.2d 1049, 1056 (2d Cir. 1985); Leigh v. Engle, 727 F.2d 113, 138-39 (7th Cir. 1984). Here, the Secretary offered abundant evidence, including

Holloway's own admissions, that the plan did not keep adequate records and that this state of affairs hobbled the ability of the plan administrators to pay claims.

Moreover, it is the ill-gotten profit that other fiduciaries and plan service providers, including Defendant Doyle and his company, took as improper fees for nonexistent or unnecessary services, and the plan losses in the form of these diverted assets, rather than the unpaid claims, that the Secretary seeks to recover. Under ERISA section 409(a), plan fiduciaries are not just personally liable for plan losses resulting from their breaches, they are also liable "to restore to such plan any profits of such fiduciary which have been made through use of assets of the plan by the fiduciary, and shall be subject to such other equitable or remedial relief as the court may deem appropriate, including removal of such fiduciary." 29 U.S.C. § 1109(a). And under ERISA section 405, as we discuss, infra, at p. 10, fiduciaries may be held liable for losses caused by other fiduciaries to the extent that their own breaches enabled their co-fiduciaries to breach their duties. Because it is the recovery of diverted plan assets that the Secretary seeks here, as well as injunctive relief barring the defendants from serving as plan fiduciaries and service providers in the future, it was not necessary for the Secretary to prove the exact measure or even the existence of any unpaid claims. Thus, the district court's focus on unpaid claims and its failure to address the Secretary's argument with regard to the diversion of plan assets, was in error.

2. Plan Contributions

The district court likewise erred in focusing on plan contributions, because the Secretary's case does not turn, ultimately, on any deficiency in these contributions. Nevertheless, contrary to Holloway's contention that the Secretary failed to introduce evidence of unpaid contributions, the evidence in fact shows, as the district court recognized, that Holloway knew that by September 20, 2002, PCI/North Point had stopped making contributions to the Fund and that the Fund’s accountant could not determine the amount of contributions. JA 10, 12-13. Indeed, Holloway resigned, in her own words, based on the "lack of financial accountability for contributions to the Fund and resultant lack of funding to pay claims." Id. at 14.

But, as with the unpaid claims issue, evidence of unpaid contributions and the lack of accounting for the contributions was offered by the Secretary as evidence of the fiduciary breaches by Holloway as trustee and not as the measure of monetary relief. The Secretary was entitled under ERISA section 409 to sue for the return of Doyle's improper gains and losses to the plan in the form of unreasonable and indeed unnecessary fees and to hold

Holloway accountable for this amount, because, as discussed below, her own breaches in failing to ensure that the Fund was run properly and had adequate administrative mechanisms allowed Doyle and others to divert plan assets.

3. Excessive Fees

As we argued in our opening brief, the Secretary did show that plan assets from both Checks 1 and 2 were paid for services that were unnecessary, non-existent or in violation of state law. Sec'y Br. at 36-41. Such "fees" are inherently excessive and violate not only ERISA's prudence and loyalty requirements, but also its requirement that plan assets be used solely to pay benefits and to defray reasonable expenses. See 29 U.S.C. § 1104(a)(1)(A).

4. Holloway's Duty of Inquiry

Nor is Holloway correct that, despite the numerous and rather alarming red flags of which she was admittedly aware, she had no duty to inquire further simply because the Fund had a third party administrator who was charged with these duties as well. Indeed, as Holloway undoubtedly knew, the Fund went through four administrators during its short, two-year tenure, all of whom complained about the endemic administrative and recordkeeping problems that they could not resolve and all of whom resigned. JA 10, 15. Moreover, the record established that, by her own admissions, she had "concerns" about another trustee Weinstein she appointed, id. at 14, which were plainly well-founded given the fact that Holloway had just been informed by the second plan administrator that Weinstein's company (Union Privilege Care), the previous administrator for the Fund, had probably not paid claims in some time and refused to provide the administrator with the "necessary financial information and documents." Id. at 10, 12. The Secretary is not required to show that these red flags indicated "nefarious conduct" or that the plan was "seriously underfunded," Holloway Br. at 20, in order to establish that Holloway breached her duties as trustee by not making any serious or sustained effort to put the Fund's house in order. Regardless of how Holloway now chooses to characterize the "administrative issues" with the Fund that she was well aware of when she was trustee, see id. at 20, 24, the fact of the matter is that Holloway did not resolve them either during her tenure as trustee or afterward, and instead simply resigned when the going got tough, as we discuss next.

Nor, as we argued in our opening brief, were the "affirmative steps" that the district court relied on in finding that Holloway met her duties – at some point asking the Fund's attorney to straighten things out and taking some unsuccessful steps before resigning to obtain basic membership information – adequate to the task, because all of these issues still existed when she resigned. Sec'y Br. at 19-20 (citing JA 13). Her effort and actions were simply not consistent with the standard imposed by ERISA on a trustee, such as Holloway, "of an express trust – the highest known to the law." Donovan v. Bierwirth, 680 F.2d 263, 272 n. 8 (2d Cir. 1982) (citation omitted).

5. Holloway's Resignation

Despite Holloway's rather candid resignation letter which explained the many issues with recordkeeping and benefit payments that led her to resign, JA 14, Holloway insists that she met ERISA's exacting standard of care in resigning when the Fund was in a "chaotic" condition. Id. at 18. She primarily relies on the fact she continued to be active in Fund management after her resignation.

Holloway cannot, however, take cover behind her post-resignation actions. Although she did, as the district court found, JA 15, secure the payment of some pending benefit claims, she only did so for her own EDI employees and for employees of ECI, a company that had sued her for her fiduciary breaches. JA 194-196.

6. Co-fiduciary Liability

Holloway next argues that she cannot be liable under ERISA section 405, 29 U.S.C. § 1105, for the breaches of any other fiduciary because she did not know what they were doing. Holloway Br. at 6-7, 27-28. In making this argument, however, Holloway ignores the terms of section 405(a)(2), which provide that a co-fiduciary can be held liable when "by his failure to comply with section 1104(a)(1) of this title in the administration of his specific responsibilities which give rise to his status as a fiduciary, a fiduciary has enabled such other fiduciary to commit a breach." 29 U.S.C. §1105(a)(2). The joint explanatory statement by the Committee of Conference provides a hypothetical example of conduct that section 405(a)(2) is intended to cover that is applicable to the case at hand:

> For example, A and B are co-trustees and are to jointly manage the plan assets. A improperly allows B to have sole custody of the plan assets and makes no inquiry as to his conduct. B is thereby enabled to sell the property and to embezzle the proceeds. A is to be liable for a breach of fiduciary responsibility.

<u>See</u> H.R. Conf. Rep. No. 1280, 93d Cong., 2d Sess. (1974), <u>reprinted in</u> 1974 U.S.C.C.A.N. 4639, 5038, 5080.

Here, the trustees, including Holloway, were required both by ERISA and the plan documents to maintain custody of the Fund's assets and hold them in trust. <u>See</u> 29 U.S.C. § 1003; JA 342. Holloway utterly failed to ensure that all contributions were received from participating employers, held in trust, and not diverted; that there was a mechanism for the trustees or anyone else administering the plan to know whom Doyle had enrolled in the Fund; that eligibility determinations were made and benefit claims were paid; that there was any mechanism for determining whether the Fund was solvent; or that the necessary financial and claims records were created and maintained. These functions are the "principal statutory duties imposed on trustees" like Holloway. Massachusetts Mut. Life Ins. Co. v. Russell, 473 U.S. 134, 142-43 (1985).

Thus, Holloway not only beached her own duties as trustee by failing to establish and enforce a basic administrative structure to account for and hold the Fund's assets in trust for the benefit of the plan participants and beneficiaries, her failures in this regard enabled Doyle and other plan fiduciaries and providers to divert plan assets. Her breaches created an administrative no-man's land in which Doyle and PCI-North Point were able to exercise control over the Fund's assets, and do with them what they chose with little or no accountability. See Free v. Briody, 732 F.2d 1331, 1335-36 (7th Cir. 1984) (trustee's failure to take any action to identify or control plan assets or ensure they would be protected from loss contributed to plan losses caused by co-fiduciary's breach). The district court not only failed to address the argument that Holloway breached her own duties as a trustee by failing to ensure that there was any adequate administrative structure, but also failed to address her liability (and Doyle's) as co-fiduciaries in this regard.

For all these reasons, this Court should reverse the district court's entry of judgment in favor of Holloway, and for at least two more as well. First, the issue whether Holloway breached her ERISA duties in her shoddy work as plan trustee, an issue that the district court did not expressly resolve, is separate from any issue concerning the extent of her monetary liability. Second and relatedly, the Secretary sought, in addition to monetary remedies, a permanent injunction barring Holloway and Doyle from serving in the future as service providers or fiduciaries to plans. Because the court below also did not address and resolve this issue, at a minimum, this Court should remand the case for the district court to consider whether the Secretary is entitled to injunctive relief even if she did not adequately establish Holloway's monetary liability.

II. THE DISTRICT COURT FAILED TO ADDRESS THE SECRETARY'S EVIDENCE ESTABLISHING THAT THE MONEY COLLECTED THROUGH CHECK 2 CONSTITUTED PLAN ASSETS

Holloway also argues that she is not liable to restore any diverted assets because the money paid by employers through Check 2 did not constitute plan assets. Holloway Br. at 29-32. She relies primarily on language in the collective bargaining agreements, which none of the employers who were paying money into the Fund saw or were signatories to, and says that this language controls the analysis to the exclusion of the documents that were given to these employers.[1] JA 421-439; 440-451. She also argues that participating employers allegedly were informed that payroll services in addition to health benefits were available, and one employer testified that his company used the payroll services. Holloway Br. at 32-33.

The Secretary has already addressed at some length in her opening brief how the documents that were given to the participating employers, particularly the New Business Turn-In Form, are most naturally understood under ordinary notions of property rights to provide that the total amount paid by the participating employers (through what later turned out to be two checks) are plan assets being paid into a funded trust. Sec'y Br. at 27-31. Suffice it to say here that the district court never addressed any of the evidence that either the Secretary or Holloway cites in this regard and, indeed, simply did not expressly resolve the issue whether <u>any</u> of the money

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[1] Holloway also relies on a document that she calls the PEO Plan Rates statement and identifies as Ex. P-21. This document, however, was never admitted into evidence and therefore, pursuant to an email conversation with Holloway's attorney, we have not included this document in the Joint Appendix. And for this reason, this Court should not rely on this document.

paid through Check 1 or Check 2 constituted plan assets. For this reason alone, the case should at least be remanded.

Moreover, Holloway does not appear to dispute that the Check 1 funds were plan assets, nor does she specifically address the Secretary's argument that the money taken out of Check 1 as "union dues" and other fees were not legitimate, and thus not reasonable, plan expenses. See Sec'y Br. at 36-39. Holloway also does not address the point raised in the Secretary's opening brief that the district court's own findings establish that at least $755,000 in plan assets from Check 1 was retained by Doyle without any explanation whatsoever. See id. at 24-25 (citing JA 15). This is another critical issue which the district court did not resolve.

III. DOYLE EXERCISED CONTROL OVER PLAN ASSETS AND ACCORDINGLY WAS AN ERISA FIDUCIARY

Although, under ERISA, a person is a fiduciary to the extent that he exercises any control over plan assets, 29 U.S.C. § 1002(21)(A), Doyle insists that he is not a fiduciary with respect to the Fund because he held no formal fiduciary position and performed only in a ministerial capacity respecting the Fund. Informal Brief in Opposition From Pro Se Appellee James M. Doyle (Doyle Br.) at 8-9. In this regard, he insists that the money he received through Check 2 did not constitute plan assets because he was contractually entitled to receive it pursuant to the marketing agreement he negotiated with PCI/North Point. Id. at 1-3. He further contends that he simply passed on to PCI/North Point the money collected through Check 1 without depositing, negotiating, or diverting any amounts from Check 1 and thus performed merely ministerial functions with regard to Check 1. Id. at 4.

As discussed above, however, supra, at p. 14, according to the district court's findings, Doyle retained $755,000 from Check 1. Thus, Doyle did manage and dispose of assets (which he does not seem to dispute are plan assets), and he was therefore a fiduciary under ERISA.

In addition, Doyle exercised sole control over the initial lump sum payment required under the CBA. He deposited that amount into a PCMG account. He then distributed the money from a PCMG account that he controlled to PCI/North Point for its service fee, to PCMG for its fees, and to PITWU for union dues, and the Fund. JA 136-137.

Doyle also exercised sole control over both Checks 1 and 2 from November 2002 through May 2003 after he stopped forwarding money to PCI/North Point, and began paying the Fund's administrator directly. Sec'y Br. at 33; JA 254-256. None of this control that Doyle asserted over plan assets was ministerial within the meaning of the Department's Interpretive Bulletin, 29 C.F.R. § 2509.75-8.

Doyle also cites the Third Circuit's decision in Confer v. Custom Engineering Co., 952 F.2d 34 (1991), as support for his argument that he cannot be personally liable because at all times he was acting as PCMG's president rather than in his personal capacity. Doyle Br. at 9-10. In Confer, the Third Circuit concluded that claims against individual corporate officers were properly dismissed because "when an ERISA plan names a corporation as a fiduciary, the officers who exercise discretion on behalf of that corporation are not fiduciaries within the meaning of section 3(21)(A)(iii), unless it can be shown that these officers have individual discretionary roles as to plan administration." 952 F.2d at 38 (emphasis omitted). Confer has no application here. Doyle's company, PCMG, is not the named fiduciary of the Fund, and the Secretary is not alleging that Doyle was acting on behalf of a named fiduciary plan sponsor. Here, the Secretary is simply alleging that Doyle is a fiduciary and thus personally liable for his breaches because he personally exercised control over plan assets.[2]

[2] On March 2, 2011, the Secretary received, for the first time through the CM/ECF system, a brief from pro se Defendant Michael Garnett, a paper copy of which was apparently filed in this Court on November 26, 2010. Garnett did not, however, file a notice of appeal from the district court's decision entering a default judgment against him. For this reason, this Court lacks jurisdiction to consider the arguments in his brief, see Kelley v. TYK Refractories Co., 860 F.2d 1188, 1199 n. 2 (3d Cir. 1988), and the Secretary accordingly does not address these arguments in her brief.

CONCLUSION

The defendants have not refuted the Secretary's arguments on appeal. The court should therefore reverse the district court's judgment.

Respectfully submitted,

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MARCH 4, 2011

CERTIFICATE OF COMPLIANCE WITH RULE 32(a)

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FOR CASE NO. 10-3598

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/s/ Marcia Bove
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Dated: March 4, 2011

CERTIFICATE OF VIRUS CHECK

I hereby certify that a virus check, using McAfee Security VirusScan Enterprise 8.0, was performed on the PDF file and paper version of this brief, and no viruses were found.

/s/ Marcia Bove
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Dated: March 4, 2011

CERTIFICATION OF BAR MEMBERSHIP

Pursuant to Local Rules 28.3(d) and 46.1(e), the undersigned counsel certifies that she has been admitted to this Court.

Dated: March 4, 2011

/s/ Elizabeth Hopkins
ELIZABETH HOPKINS

CERTIFICATE OF SERVICE AND ECF COMPLIANCE

I certify that on this 4th day of March, 2011, true and correct copies of the foregoing – THE SECRETARY OF LABOR'S REPLY BRIEF – were filed electronically with the Clerk of the Court for the United States of Appeals for the Third Circuit by using the appellate CM/ECF system. I further certify that I caused 10 copies of the Brief to be dispatched to the Clerk of this Court by UPS. I further certify that I served this Brief electronically via email on the following counsel of record:

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I also certify that I served the Brief on James Doyle, Michael Garnett and Mark Maccariella by U.S. mail, postage prepaid at the address below:

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