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# ERISA -- Nieto v. Ecker: The Propriety of Non-fiduciary Liability Under Section 409

Kevin B. Bogucki

Charles P. Cullen

Judith Ann Hagley

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## CASE COMMENT

### ERISA — *NIETO V. ECKER*: THE PROPRIETY OF NON-FIDUCIARY LIABILITY UNDER SECTION 409

Since *Freund v. Marshall & Ilsley Bank*,<sup>1</sup> non-fiduciaries have been liable under section 409(a) of the Employee Retirement Income Security Act of 1974<sup>2</sup> (ERISA) for knowingly aiding and abetting a fiduciary in the breach of a duty. In May of 1988, however, the unquestioned acceptance of non-fiduciary liability under ERISA came to a grinding halt. In *Nieto v. Ecker*,<sup>3</sup> the Ninth Circuit Court of Appeals refused to recognize section 409(a) liability for assisting in a fiduciary breach. The *Nieto* court argued that courts accepting *Freund* "uncritically adopted [its] reasoning,"<sup>4</sup> which ignored the "plain meaning" of section 409(a)<sup>5</sup> and misread ERISA's legislative history. In sharp contrast to *Freund*, the *Nieto* court found no support for the proposition that ERISA's legislative history called for a section 409(a) cause of action against non-fiduciaries.<sup>6</sup> However, *Nieto* did leave open the possibility of recovery under section 502 of ERISA.<sup>7</sup>

If a majority of the courts accept *Nieto*, plan participants and beneficiaries will no longer be able to rely on section 409(a) as a means of recovery from non-fiduciaries who misappropriate plan funds. As a result, ERISA's purpose of protecting "the interests of participants in employee benefit plans and their beneficiaries"<sup>8</sup> would be circumvented unless the courts accept an alternate theory of recovery. This Comment will explore the *Nieto* decision and its potential impact on the interpreta-

1 485 F. Supp. 629 (W.D. Wis. 1979).

2 29 U.S.C. § 1001 (1982). Section 409(a) of ERISA provides:

Any person who is a fiduciary with respect to a plan who breaches any of the responsibilities, obligations, or duties imposed upon fiduciaries by this subchapter shall be personally liable to make good to such plan any losses to the plan resulting from each such breach, and 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. A fiduciary may also be removed for a violation of section 1111 of this title.

29 U.S.C. § 1109(a) (1982).

3 845 F.2d 868 (9th Cir. 1988). See *infra* notes 30-40 and accompanying text.

4 *Id.* at 871.

5 *Id.* ("The plain language of section 409(a) limits its coverage to fiduciaries, and nothing in the statute provides any support for holding others liable under that section.").

6 *Id.* at 872.

7 The Ninth Circuit remanded on the basis that plaintiffs stated a claim for relief under §§ 406 and 502 of ERISA. See *infra* notes 39-40 and accompanying text. Section 406 prohibits certain transactions with parties in interest. 29 U.S.C. § 1106. Frommer met the ERISA § 3(14)(B) definition of "party in interest" because he provided services to the Funds. 29 U.S.C. § 1002(14)(B). If Frommer violated § 406, plaintiffs would be entitled to equitable relief under § 502. Section 502 expressly authorizes such relief to redress violations of either subchapter 1 of ERISA, including § 406, or the terms of the pension plan. The court interpreted "equitable relief" within § 502 to encompass state law remedies "including the issuance of an injunction or the imposition of a constructive trust." 845 F.2d at 874. The court also noted that in contrast to § 409, § 502 is not limited to fiduciaries and therefore an ERISA violation by a non-fiduciary would fall within its scope.

8 29 U.S.C. § 1001(b).

tion of sections 409(a) and 502. Part I provides a brief background of the relevant provisions of ERISA. Part II analyzes the reasoning of *Freund* and *Nieto* and describes the circumstances surrounding the two cases. Part III argues that the *Nieto* court was correct in ruling that section 409(a) does not provide for non-fiduciary liability. Part IV suggests that, consistent with ERISA's purpose and structure, a constructive trust provides an authorized equitable remedy under section 502, and therefore obviates the necessity of non-fiduciary liability.

## I. Background and Relevant Sections of ERISA

Prior to the enactment of ERISA in 1974, federal regulation of the private pension system was governed by the Welfare and Pension Plans Disclosure Act.<sup>9</sup> The Disclosure Act indirectly controlled pension plans by awarding tax benefits<sup>10</sup> to those plans that qualified under specific provisions of the Internal Revenue Code.<sup>11</sup> Since the Act sanctioned violations of the Internal Revenue Code provisions only by withdrawing a plan's tax-exempt status, enforcement of the Act primarily affected the plan's intended beneficiaries. This adverse impact frustrated the purpose behind pension plans and Congress eventually questioned the Act's effectiveness.<sup>12</sup>

In order to effectively govern the rapidly expanding pension industry,<sup>13</sup> Congress passed ERISA in 1974 as a "comprehensive remedial statute designed to 'protect . . . the interests of participants in employee

9 Pub. L. No. 85-836, 72 Stat. 997 (1958), *repealed by* Employee Retirement Income Security Act of 1974 § 111(a)(1), 88 Stat. 829, 851. The drafters of ERISA recognized the need for a comprehensive federal statute covering pension plans, in part because the Disclosure Act was "wholly lacking in substantive fiduciary standards." S. REP. NO. 127, 93d Cong., 2d Sess., *reprinted in* 1974 U.S. CODE CONG. & ADMIN. NEWS 4639, 4841. *See generally* Note, *Fiduciary Standards and the Prudent Man Rule Under the Employee Retirement Income Security Act of 1974*, 88 HARV. L. REV. 960 (1975).

10 Plans that qualified under the Internal Revenue Code were granted the following tax benefits: 1) the employer could deduct his contributions to the plan; and 2) the employee was not taxed on his share of the employer's contributions or on the investment income those contributions generated until he actually received benefits upon retirement or plan termination. *See* I.R.C. §§ 401(a), 402(a), 404(a), 501(a) (1954) (current version at I.R.C. §§ 401(a), 402(a), 404(a), 501(a), (c)22 (1982 & Supp. IV 1986)).

11 In order to qualify for a tax exemption, a pension plan had to be written, permanent, for the exclusive benefit of covered employees, and could not discriminate in favor of highly-paid employees. I.R.C. § 401(a) (1954) (current version at I.R.C. § 401(a) (1982 & Supp. IV 1986). *See, e.g.*, *Winger's Dept. Store, Inc.*, 82 T.C. 869 (1984) (plan which made loans to the employer's business was not operated for the "exclusive benefit of the employees"); *Wisconsin Nipple & Fabricating Corp. v. Commissioner*, 581 F.2d 1235 (7th Cir. 1978) (plan discriminated where five of six covered employees, out of 20 full-time employees, were highly compensated).

12 *See* S. REP. NO. 383, 93d Cong., 2d Sess. 18, *reprinted in* 1974 U.S. CODE CONG. & ADMIN. NEWS 4639, 4890. Prior to the enactment of ERISA, it appeared that pensions were subject to a wide variety of abuses. For example, the employer could either terminate the plan at any time or fire his workers prior to vesting. In either case, workers could suffer large capital losses. In addition, the long-term nature and complexity of pension contracts gave rise to informational problems and difficulty in enforcing the agreements in court. These problems led Ralph Nader and Kate Blackwell to conclude that "[p]ensions are no more certain than horseraces." R. NADER & K. BLACKWELL, *YOU AND YOUR PENSION* 2 (1973).

13 At the end of 1973, the total assets of private uninsured pension plans exceeded 130 billion dollars. *See* CCH Pension Plan Guide No. 328 at 5-6 (Nov. 22, 1974). In addition, more than 35 million employees were covered by the private pension system. *See Hearings on S.4 & S.75 Before the Subcomm. on Labor of the Senate Comm. on Labor & Public Welfare*, 93d Cong., 1st Sess. 174 (1973).

benefit plans and their beneficiaries.'"<sup>14</sup> Consistent with its stated purpose, the text of ERISA and its legislative history are "replete with references to fiduciary obligations."<sup>15</sup> ERISA explicitly defines those persons considered fiduciaries in section 3(21)(a),<sup>16</sup> sets forth their duties in section 404,<sup>17</sup> and provides remedies for the breach of those duties in sections 409(a) and 502.<sup>18</sup> Despite its complex remedial scheme, however, ERISA makes "no mention of obligations for non-fiduciaries."<sup>19</sup> Accordingly, courts that have imposed non-fiduciary liability have done so by going beyond the plain language of the statute.

## II. Development of the Controversy

*Freund* initiated the idea of non-fiduciary liability under ERISA for assisting in the breach of a fiduciary duty and has become the "seminal case in this area."<sup>20</sup> The court in *Freund* established that non-fiduciaries who knowingly assist fiduciaries in breaching their duties may be personally liable under section 409(a) to make good any losses suffered by the plan. Recently, however, the Ninth Circuit in *Nieto v. Ecker* held that section 409(a) did not authorize non-fiduciary liability.<sup>21</sup> Thus, the *Nieto* decision conflicts with all previous decisions which have followed *Freund*.

14 *Eaves v. Penn*, 587 F.2d 453, 457 (10th Cir. 1978) (quoting 29 U.S.C. § 1001(b)). The regulatory effectiveness of ERISA has been questioned however. See Ippolito, *A Study of the Regulatory Effect of the Employee Retirement Income Security Act*, 31 J. L. & ECON. 85 (1988).

15 Schwartz, *Non-fiduciary Liability Under the Employee Retirement Income Security Act*, 69 MARQ. L. REV. 561, 562 (1986). See *infra* notes 16-18 and accompanying text for the ERISA sections referring to fiduciary obligations.

16 A person is a "fiduciary" to the extent "(i) he exercises any discretionary authority or discretionary control respecting management of such plan or . . . its assets, (ii) he renders investment advice for a fee or other compensation . . . or (iii) he has any discretionary authority or discretionary responsibility in the administration of such plan." 29 U.S.C. § 1002(21)(a).

17 Section 404 requires a fiduciary to act for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable administrative expenses. In dispensing with these duties, a fiduciary is also required to act in the manner of a prudent man in a like capacity. See 29 U.S.C. § 1104.

18 See *supra* note 2 for the text of § 409(a). Under § 502,

[a] civil action may be brought . . .

(2) by the Secretary, or by a participant, beneficiary or fiduciary for appropriate relief under section 1109 [409] of this title;

(3) by a participant, beneficiary, or fiduciary

(A) to enjoin any act or practice which violates any provision of this subchapter or the terms of the plan, or (B) to obtain other appropriate equitable relief (i) to redress such violations or (ii) to enforce any provisions of this subchapter or the terms of the plan . . .

29 U.S.C. § 1132.

19 Schwartz, *supra* note 15, at 562-63.

20 *Nieto*, 845 F.2d at 871. See, e.g., *Brock v. Hendershott*, 840 F.2d 339, 342 (6th Cir. 1988); *Lowen v. Tower Asset Management, Inc.*, 829 F.2d 1209, 1220-21 (2d Cir. 1987); *Fink v. National Sav. and Trust Co.*, 772 F.2d 951 (D.C. Cir. 1985); *Thornton v. Evans*, 692 F.2d 1064, 1078 (7th Cir. 1982); *Fremont v. McGraw-Edison Co.*, 606 F.2d 752 (7th Cir. 1979), *cert. denied*, 445 U.S. 951 (1980); *Foltz v. U.S. News & World Report, Inc.*, 627 F. Supp. 1143 (D.D.C. 1986); *Donovan v. Schmuttey*, 592 F. Supp. 1361 (D. Nev. 1984); *Donovan v. Bryans*, 566 F. Supp. 1258 (E.D. Pa. 1983); *McDougall v. Donovan*, 539 F. Supp. 596 (N.D. Ill. 1982).

21 *Nieto*, 845 F.2d at 873.

### A. *The Leading Case: Freund v. Marshall & Ilsley Bank*

In *Freund v. Marshall & Ilsley Bank*,<sup>22</sup> trustees of an ERISA plan<sup>23</sup> loaned virtually all of the assets of the plan back to sponsoring companies in exchange for unsecured promissory notes. The lack of security on the notes presented significant risks for the plan, and the interest rates paid on the notes did not adequately compensate for these risks. As a result, the invested plan assets were lost and the beneficiaries brought suit.<sup>24</sup>

In its analysis, the *Freund* court first determined that the trustees of the plan were in breach of various ERISA sections concerning fiduciary responsibilities.<sup>25</sup> Next, the court reasoned that because Congress intended ERISA to federalize the common law of trusts, traditional principles of trust law should apply to ERISA.<sup>26</sup> The law of trusts holds non-fiduciaries liable for assisting a fiduciary in breaching his duties.<sup>27</sup> The beneficiary, as the equitable owner of trust assets, has a cause of action against anyone who interferes with those assets.<sup>28</sup> Based on this reason-

22 485 F. Supp. 629 (W.D. Wis. 1979).

23 The plan in *Freund* was "a system of employer and employee contributions to a trustee fund, with contributions and investment earnings of the fund's assets being allocated to individual accounts." *Id.* at 634. This plan "by 'the express terms' of the Plan document was established to provide retirement income to employees of the sponsoring companies and this fact alone establishes ERISA coverage." *Id.*

24 *Id.* at 636.

25 The court held that the trustees, as fiduciaries, violated the duty of prudence imposed by § 404(a)(1)(A), (B) of ERISA because they permitted the plan's assets to be loaned back to the companies who sponsored the plan; that by loaning the assets back to the sponsoring companies, the trustees failed to diversify the investment of the plan as required by § 404(a)(1)(C) of ERISA; and that since each of the sponsoring companies was a "party in interest" (because each company had employees who were participants in the plan), the trustees violated § 406(a) of ERISA which proscribes transactions between plan and parties in interest. *Id.* at 639.

26 *Id.* at 635.

27 *Id.* at 641-42. The court stated:

While only fiduciaries can violate the fiduciary responsibility provisions of Title I of ERISA, it does not follow from that fact that relief may be awarded only against the breaching fiduciaries. In view of the expressed Congressional intent in enacting ERISA "to make applicable the law of trusts," the Court is fully empowered to award the relief available in traditional trust law against non-fiduciaries who knowingly participate, either directly or through an agent, in a breach of trust.

Under traditional principles of trust law a third party who assisted a trustee in committing a breach of trust could be held liable in an action brought by the beneficiary.

The court assumed, however, that every principle from the traditional law of trusts can freely be incorporated into ERISA, and thus can transform a state cause of action into a federal one. For further analysis of *Freund's* rationale, see *infra* notes 57-62 and accompanying text.

28 *Id.* at 642. The court, quoting G. BOGERT, *THE LAW OF TRUSTS AND TRUSTEES* § 901 (2d ed. rev. 1978), stated:

Just as every owner of a legal interest has the right that others shall not, without lawful excuse, interfere with his possession or enjoyment of the property or injuriously affect its value, so the cestui, as an equitable owner in the trust res, has the right that third persons shall not knowingly join with the trustee in a breach of trust . . . The wrong of participation in a breach of trust is divided into two elements, namely (1) an act or omission which furthers or completes the breach of trust by the trustee; and (2) knowledge at the time that the transaction amounted to a breach of trust, or the legal equivalent of such knowledge.

See *Blankenship v. Boyle*, 329 F. Supp. 1089 (D.D.C. 1971) (pre-ERISA case). Knowledge of the breach is a necessary element for liability under traditional trust law. *Freund* appeared to accept knowledge (or its legal equivalent) as a requisite for liability but did not really address the question. The court noted that it "need not reach the question whether, absent direct knowledge that a breach was occurring, the non-fiduciary sellers were on notice of such facts about a potential breach that

ing, the court concluded that the sponsoring companies were personally liable under section 409(a) of ERISA for knowingly participating in the fiduciary's breach of duty.<sup>29</sup>

### B. *The New Alternative: Nieto v. Ecker*

In contrast to *Freund*, the court in *Nieto v. Ecker*<sup>30</sup> held that section 409(a) does not authorize non-fiduciary liability.<sup>31</sup> The plaintiffs in *Nieto* were members of labor unions which had entered into agreements with various associations of employers to establish trust funds ("the Funds") to be financed by mandatory employer contributions.<sup>32</sup> An attorney, Frommer, was retained by a group of multi-employer pension plans to collect delinquent contributions from these employers. The plaintiffs sued Frommer for breach of fiduciary duty under ERISA, alleging that he "had repeatedly failed to prosecute lawsuits to collect delinquent contributions and had been paid attorney's fees for services that he did not render."<sup>33</sup>

The plaintiffs first argued that Frommer was a fiduciary of the Funds within the meaning of ERISA and was, therefore, subject to all the duties and liabilities imposed on fiduciaries.<sup>34</sup> The court held that Frommer, as an independent attorney, was not a fiduciary under ERISA.<sup>35</sup> The plaintiffs then argued that even if Frommer was not a fiduciary, he could still be held liable under ERISA section 409(a) as one who conspired and acted with fiduciaries in the breach of their fiduciary duties.<sup>36</sup> Ruling against the previous decisions, the court held that only fiduciaries as defined by ERISA may be sued under section 409(a).<sup>37</sup> The court intimated that *Freund* is fundamentally flawed and that courts accepting it have done so uncritically.<sup>38</sup>

The *Nieto* court did not hold Frommer liable as a non-fiduciary under section 409(a). However, the court did suggest that he might be

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they had a duty to inquire further to determine whether the breach was occurring." *Freund*, 485 F. Supp. at 642 n.6.

29 *Freund*, 485 F. Supp. at 642.

30 845 F.2d 868 (9th Cir. 1988).

31 *Id.* at 873.

32 *Id.* at 870. The Funds are multiemployer plans subject to ERISA, and the plaintiffs are, by virtue of their membership in the unions, participants in the funds.

33 *Id.* The plaintiffs joined the Funds and their trustees as defendants in federal district court. The district court dismissed a pendent state claim and the ERISA claims against Frommer. The plaintiffs have appealed only the dismissal of the ERISA claims against Frommer. *Id.*

34 *Id.*

35 *Id.* at 871. The Ninth Circuit resolved this issue in *Yeseta v. Bairnes*, 837 F.2d 380, 385 (9th Cir. 1988) which held that "an attorney rendering professional services to a plan is not a fiduciary so long as he does not exercise any authority over the plan 'in a manner other than by usual professional functions.'" *Nieto*, 845 F.2d at 870. The complaint in *Nieto* did not allege that Frommer exercised any such authority over the Funds. *Id.* The *Nieto* court refused to expand the meaning of fiduciary past the limits set by *Yeseta*, and Frommer, therefore, was not held to be a fiduciary.

36 *Nieto*, 845 F.2d at 871.

37 The court in *Nieto* noted that the plain language of the section limits its coverage to fiduciaries. *Id.* at 873. See *infra* notes 45-52 and accompanying text for the analysis of the plain language argument.

38 *Id.* at 871.

liable as a "party in interest" under sections 406(a)(1) and 408(b).<sup>39</sup> The court added that if the non-fiduciary could be found liable under these sections, appropriate equitable relief would be available under section 502(a)(3).<sup>40</sup>

### III. Analysis of the *Nieto* Decision

The *Nieto* court rejected *Freund* and its progeny for a number of reasons. First, the *Freund* court ignored the "plain meaning" of section 409.<sup>41</sup> Second, the *Freund* court relied on a dubious interpretation of one Senator's statement that Congress intended ERISA to incorporate "the complete body of state trust law."<sup>42</sup> Third, the Supreme Court established a presumption that ERISA was not intended to be supplemented by state law causes of action because ERISA is complex and complete.<sup>43</sup> Fourth, and finally, the non-fiduciary liability was a "cause of action" and not a "remedy" which could be properly fashioned within the limits of ERISA.<sup>44</sup>

#### A. The Plain Language Argument

The *Nieto* court argued that the plain language of section 409(a)<sup>45</sup> limits its application to "fiduciaries" and that there is no room for non-fiduciary liability under this section.<sup>46</sup> The statute clearly states that only those persons who are defined as "fiduciaries" in the other sections of ERISA should be held "personally liable."<sup>47</sup> This interpretation is in sharp contrast to *Freund*, which held that aiding and abetting in a fiduciary breach could render a non-fiduciary liable under section 409(a).<sup>48</sup>

Despite Judge Wiggins' arguments in the *Nieto* concurrence,<sup>49</sup> the *Nieto* court correctly concluded that section 409(a) provides a remedy

39 Because Frommer, as an attorney, provided services to the fund, he was a "party in interest" under ERISA § 3(14)(B). Section 406 of ERISA prohibits certain transactions between ERISA plans and their parties in interest. As the *Nieto* court noted, "[s]ome of the allegations in the complaint, if true, establish that Frommer participated in such 'prohibited transactions' with the Funds by receiving excessive compensation for legal services, obtaining a loan from the Funds, and engaging in similar activities in violation of ERISA §§ 406(a)(1), 408(b)." *Id.* at 873.

40 *Nieto*, 845 F.2d at 873. See also *McDougall v. Donovan*, 539 F. Supp. 596, 598-99 (N.D. Ill. 1982) (section 502(a)(3) permits a court to order equitable relief against a party in interest who engages in a prohibited transaction).

41 See *infra* text accompanying notes 45-52.

42 See *infra* text accompanying notes 53-66.

43 *Massachusetts Mut. Life Ins. Co. v. Russell*, 473 U.S. 134 (1985); see *infra* text accompanying notes 67-77.

44 See *infra* text accompanying notes 78-91.

45 Section 409(a) of ERISA, 29 U.S.C. § 1109(a), applies to "[a]ny person who is a fiduciary." (Emphasis added).

46 *Nieto*, 845 F.2d at 872. The court stated: "Congress has provided a remedy against fiduciaries alone in section 409(a) and we see no basis for reading into that section a remedy against non-fiduciaries as well." *Id.*

47 *Id.* at 871.

48 *Freund*, 485 F. Supp. at 641-42.

49 *Nieto*, 845 F.2d at 874 (Wiggins, J., concurring). The concurring opinion in *Nieto* supported the reasoning in *Freund*. Judge Wiggins argued that § 409(a) should not be read in isolation, but rather should be read in relation to ERISA's other sections (namely § 502), and in relation to the general purposes behind ERISA as a whole. *Id.* at 875. According to Judge Wiggins, because § 502 allows for "other equitable or remedial relief" and because the overall goal of ERISA is to provide effective remedies to plan beneficiaries, § 409(a) should be given as broad a construction as possible.

only against fiduciaries.<sup>50</sup> Nowhere in 409(a) is there any suggestion that anyone other than a breaching fiduciary should be held personally liable to the plan.<sup>51</sup> As Judge Wiggins suggested, the justification for non-fiduciary liability under section 409(a) would have to arise, if at all, from some source other than the plain language of ERISA.<sup>52</sup> In the absence of some other justification, the *Nieto* court must have correctly held that section 409(a) applies only to "fiduciaries."

### B. Legislative Intent

By carefully crafting the provisions of ERISA, Congress hoped that "[t]he uniformity of decision which the Act is designed to fasten [would] help administrators, fiduciaries and participants to predict the legality of proposed actions without the necessity of reference to varying state laws."<sup>53</sup> Unfortunately, as evidenced by the circuit conflict, the courts have not carried congressional hopes to fruition. In *Nieto*, the court relied primarily on the "plain language" of section 409 in determining the issue before it,<sup>54</sup> and apparently felt no need to delve beneath the surface of the statute.<sup>55</sup> Such an analysis is deceptively simple, however, because several courts have imposed liability on non-fiduciaries under section 409(a).<sup>56</sup> These courts adopted the reasoning developed in *Freund*, which based its holding on the legislative history. To determine whether there is a sound basis for *Freund*'s rationale, therefore, one must examine ERISA's legislative history.

Central to the *Freund* court's argument is a statement made during congressional debate on ERISA by Senator Williams, the chairman of the Senate Committee on Labor and Public Welfare and one of the sponsors of ERISA. While describing the goals of the fiduciary liability provisions of ERISA, Senator Williams commented:

The objectives of these provisions are to make applicable the law of trusts; to prohibit exculpatory clauses that have often been used in this field; to establish uniform fiduciary standards to prevent transac-

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Otherwise, ERISA would provide less protection than had been available under state law and the purpose of ERISA would be frustrated. *McDougall v. Donovan*, 539 F. Supp. 596, 599 (W.D. Ill. 1982) ("ERISA should not be read so narrowly as to defeat these principles of the common law of trusts"). This, coupled with the argument that the federal courts are empowered to "fashion a body of federal common law" to effectuate the ends of ERISA (*Massachusetts Mut. Life Ins. Co. v. Russell*, 473 U.S. 134, 156 (1985); *Shaw v. Kruidenier*, 470 F. Supp. 1375, 1382 (S.D. Iowa 1979), *aff'd*, 620 F.2d 307 (8th Cir. 1980)), led Judge Wiggins to conclude that § 409(a) liability was not meant to be limited solely to fiduciaries. *Nieto*, 845 F.2d at 875.

<sup>50</sup> *Nieto*, 845 F.2d at 874.

<sup>51</sup> See *supra* note 2.

<sup>52</sup> See *supra* note 49.

<sup>53</sup> S. REP. NO. 127, 93d Cong., 2d Sess., reprinted in 1974 U.S. CODE CONG. & ADMIN. NEWS 4639, 4865.

<sup>54</sup> *Nieto*, 845 F.2d at 871. See *supra* notes 45-52 and accompanying text.

<sup>55</sup> Because *Freund* and the cases following it referred to the legislative history of ERISA as the rationale for incorporating a state law cause of action into § 409, the *Nieto* court did consider the legislative history. But the court felt that § 409 was clear on its face and that "legislative history is irrelevant to the construction of an unambiguous statute." *Id.* at 872 n.2.

<sup>56</sup> See, e.g., *Brock v. Hendershott*, 840 F.2d 339, 342 (6th Cir. 1988); *Lowen v. Tower Asset Management, Inc.*, 829 F.2d 1209, 1220-21 (2d Cir. 1987); *Thornton v. Evans*, 692 F.2d 1064, 1078 (7th Cir. 1982).



tions which dissipate or endanger plan assets; and to provide effective remedies for breaches of trust.<sup>57</sup>

The court in *Nieto* noted this excerpt from ERISA's legislative history and concluded that "it provides no basis for departing from the plain meaning of the statute."<sup>58</sup> The court reasoned that:

*Freund* and the cases following it have built very much on very little. As we read Senator Williams' statement, it merely directs the courts to rely on state law principles in adjudicating claims otherwise within the scope of the Act. . . . [I]t provides no support for the incorporation of state law causes of action as a supplement to the explicit provisions of ERISA.<sup>59</sup>

The legislative history of ERISA does not refer to the obligations or standards of behavior required of non-fiduciaries.

*Freund* found support for non-fiduciary liability under section 409 not from the legislative history but from the traditional law of trusts.<sup>60</sup> The *Freund* court attempted to weave together ERISA and the common law of trusts with the comment made by Senator Williams.<sup>61</sup> From this statement, the *Freund* court made a leap of faith and presumed that Congress intended "to federalize the common law of trusts" in enacting ERISA.<sup>62</sup> Contrary to *Freund's* assumption, the *Nieto* court explained that making "applicable the law of trusts" is not the same thing as federalizing the common law of trusts.<sup>63</sup> Congress decided to create ERISA be-

57 120 CONG. REC. 29,932 (1974), reprinted in 1974 U.S. CODE CONG. & ADMIN. NEWS 4639, 5186 (statement of Sen. Williams).

58 *Nieto*, 845 F.2d at 871. *Nieto's* analysis of the *Freund* opinion begins with the implicit premise that to depart from the plain meaning of a federal statute, a court must first provide a basis. The *Nieto* court noted that "[a]s courts of limited jurisdiction, our power to adjudicate claims is limited to that granted by Congress, and such grants are not to be lightly inferred." *Id.* at 871. Thus, the court felt that it was presumed to lack jurisdiction under § 409 unless affirmatively shown to the contrary. To act otherwise would unconstitutionally usurp judicial power from the states by cloaking a state law cause of action in federal garb.

59 *Id.* at 872.

60 *Freund*, 485 F. Supp. at 641-42. The court in *Freund* used the legislative history of ERISA as a bridge to connect the federal courts with the common law of trusts. But § 409 and the common law of trusts directly contradict one other: Section 409 explicitly requires that one be a fiduciary to be personally liable for a fiduciary breach while the common law of trusts allows liability to attach to non-fiduciaries who were involved in that breach. ERISA's legislative history does not sustain *Freund's* complete disregard of the clear language of § 409. See *infra* notes 61-66 and accompanying text.

61 *Id.* at 635.

62 *Id.* The *Freund* court focused on the beginning of Senator Williams' statement and apparently ignored the rest of it. For Senator Williams' concern with prohibiting exculpatory clauses which he expressed during the floor debate on ERISA proves that Congress did not intend to federalize the common law of trusts. The prohibition against exculpation from liability for breach of trust originates in ERISA as compared with the often-present exculpatory provisions in trust instruments permitted under the common law of trusts. Thus, the very speech by Senator Williams upon which *Freund* bases its rationale undermines the holding of *Freund*.

63 The "fiduciary responsibility section, in essence, codifies and makes applicable to these fiduciaries certain principles developed in the evolution of the law of trusts." S. REP. NO. 127, 93d Cong., 2d Sess., reprinted in 1974 U.S. CODE CONG. & ADMIN. NEWS 4639, 4865 (emphasis added). As the *Nieto* court notes, this statement from the legislative history "does not support the broader proposition that ERISA meant to adopt the entire body of stated trust law lock, stock and barrel." *Nieto*, 845 F.2d at 872 n.2.

cause the law of trusts was inadequate and differed from state to state.<sup>64</sup> As the legislative history reveals, "[t]he principles of fiduciary conduct are adopted from existing trust law, but with *modifications* appropriate for employee benefit plans."<sup>65</sup> The *Nieto* court correctly argued that in this context, Senator Williams' statement takes on a different meaning than the *Freund* court gave it.

Congress was influenced by existing trust law when it wrote ERISA and tailored certain of its principles to fit pension plans, but evidently it did not intend the courts to revert to traditional trust law to create causes of action not found in the explicit terms of ERISA. It was Senator Williams himself who, while speaking of the necessity for ERISA, stated that "neither existing State or Federal law has been effective in preventing or correcting many [pension plan] abuses."<sup>66</sup> It appears that whatever Congress found applicable in traditional trust law, Congress itself "federalized" and incorporated into ERISA. Therefore, the *Nieto* court correctly found that the legislative intent of ERISA offers no justification for non-fiduciary liability under section 409(a).

### C. *Presumption Against Supplementation*

The fact that ERISA is such a carefully integrated system of remedies provided the *Nieto* court with a strong argument that Congress did not intend to authorize other remedies which it simply forgot to incorporate.<sup>67</sup> The *Nieto* court recognized that "where a statute expressly provides a particular remedy or remedies, a court must be chary of reading

64 As the background section of the House report reveals, "[i]n the absence of adequate federal standards, the participant is left to rely on the traditional equitable remedies of the common law of trusts." H.R. REP. NO. 533, 93d Cong., 2d Sess., reprinted in 1974 U.S. CODE CONG. & ADMIN. NEWS 4639, 4643.

65 *Id.* at 4651 (emphasis added). As Congress noted in its conference report, "reliance on conventional trust law often is insufficient to adequately protect the interests of plan participants and beneficiaries. This is because trust law had developed in the context of testamentary and inter vivos trusts." S. REP. NO. 127, 93d Cong., 2d Sess., reprinted in 1974 U.S. CODE CONG. & ADMIN. NEWS 4639, 4865. Therefore, rather than simply federalizing the traditional law of trusts, Congress found it necessary to select certain principles out of the law of trusts and then modify these principles because "the typical employee benefit plan . . . is quite different from the testamentary trust both in purpose and in nature." *Id.* at 4865.

66 *Id.* at 5186. Senator Williams also stressed that "with the narrow exceptions specified in the bill, the substantive and enforcement provisions of . . . [ERISA] . . . are intended to preempt the field for Federal regulation[.]" *Id.* at 5188.

67 *Nieto*, 845 F.2d at 872. The *Nieto* majority based this reasoning upon the United States Supreme Court case of *Massachusetts Mut. Life Ins. Co. v. Russell*, 473 U.S. 134 (1985), in which the Supreme Court held against providing extra-contractual damages which were not provided by the language of ERISA itself. The *Russell* Court reasoned: "The six carefully integrated civil enforcement provisions found in § 502(a) of the statute as finally enacted . . . provide strong evidence that Congress did not intend to authorize other remedies that it simply forgot to incorporate expressly." *Id.* at 146. As the Court noted, "where a statute expressly provides a particular remedy or remedies, a court must be chary of reading others into it." *Id.* at 147 (quoting *Transamerican Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11, 19 (1979)).

Of *Russell*, the *Nieto* majority said: "This conclusion was based on the Court's view of ERISA as a carefully crafted 'comprehensive and reticulated statute.'" *Id.* In other words, the Supreme Court had determined that ERISA's remedial scheme was so comprehensive and well thought out that it was not meant to be supplemented by other law except where specifically provided by the statute. *Id.*

others into it.'"<sup>68</sup> ERISA expressly sets out those persons who shall be defined as "fiduciaries" under the statute.<sup>69</sup> The statute then details the duties of these fiduciaries<sup>70</sup> and then, in section 409(a), provides a remedy against fiduciaries who breach their duty.<sup>71</sup> Reading these fiduciary sections together, the rational conclusion must be that Congress would not indiscriminately use the word "fiduciary" after having taken so much trouble to define it.

Furthermore, ERISA covers more than simply wrongs committed by fiduciaries. For example, ERISA defines "parties in interest"<sup>72</sup> and provides remedies against these persons for partaking in prohibited transactions.<sup>73</sup> Thus, one may reasonably conclude that ERISA's remedial sections were meant to apply only to those persons to whom each particular section applied. The *Nieto* court correctly presumed that Congress did not simply forget to provide a remedy against non-fiduciaries.<sup>74</sup>

Accordingly, it is possible within the scheme of ERISA to reach assets in the hands of persons other than fiduciaries without the necessity of imposing non-fiduciary liability under section 409(a).<sup>75</sup> Furthermore, even if the federal courts are empowered to formulate a body of federal common law to effectuate the ends of ERISA,<sup>76</sup> this power must be limited to fashioning such "other equitable and remedial relief" as is authorized by the statute, rather than fashioning new causes of action against non-fiduciaries who take possession of plan assets.<sup>77</sup>

#### D. *The Definition of "Remedies"*

ERISA sections 502 and 409, which authorize "other equitable and remedial relief," were intended to provide plan beneficiaries and participants with those equitable remedies available under state law only where they are necessary to adjudicate claims otherwise within the scope of

68 *Nieto*, 845 F.2d at 872 (quoting *Massachusetts Mut. Life Ins. Co. v. Russell*, 473 U.S. 134, 147 (1985)).

69 *See supra* note 16.

70 *See supra* note 17.

71 *See supra* note 2.

72 29 U.S.C. § 1002(14) (1982).

73 29 U.S.C. § 1106(a), (c) (1982).

74 *Nieto*, 845 F.2d at 872.

75 Using a constructive trust, a court could reach plan assets, or the value for which they are purchased, without actually imposing liability upon a non-fiduciary who has possession of the assets. *See infra* notes 92-104 and accompanying text.

76 This power would be similar to the courts' power to fashion a body of federal common law under § 301 of the Labor Management Relations Act. *Massachusetts Life Ins. Co. v. Russell*, 473 U.S. 134, 156 (1985); *Shaw v. Kruidenier*, 470 F. Supp. 1375, 1382 (S.D. Iowa 1979).

77 *Nieto*, 845 F.2d at 872 n.2. The federal courts have considerable power to fashion a federal common law under the Labor Management Relations Act because that Act is not, nor was it intended to be, as complete as ERISA and there is little statutory federal law. The Labor Management Relations Act was intended to federalize the law of labor management relations but did not intend to codify such law. Thus, "[w]here . . . claims by participants or beneficiaries do not involve application of the substantive requirements of this legislation, they may be brought in either state or federal courts of competent jurisdiction." 120 CONG. REC. 29,933 (1974) (statement of Sen. Williams). ERISA, however, was intended to both federalize and codify the law of pensions. As a result, the statute is much more comprehensive and the need for federal common law is considerably less.

ERISA.<sup>78</sup> These sections provide no support for the incorporation of state law causes of action.<sup>79</sup> Nonetheless, *Freund* and the cases following it reasoned that the words "equitable or remedial relief" should be broadly construed so as to encompass a cause of action against non-fiduciaries under section 409(a), thus providing "effective remedies" for plan participants and beneficiaries.<sup>80</sup>

As *Nieto* illustrated, this broad construction has certain flaws. If courts find non-fiduciaries liable for aiding and abetting in a fiduciary breach and hold them personally accountable to the fund for any lost proceeds, courts will have fashioned more than an "equitable remedy." In fact, they will have created a cause of action against the non-fiduciary for "aiding and abetting" a breach of fiduciary duty. Such a cause of action does not exist within the language of ERISA.<sup>81</sup> To allow the words "other equitable or remedial relief" to encompass causes of action is to give them an unjustifiably expansive interpretation.

*Nieto* correctly distinguished an equitable remedy, which may be provided under section 502, from a cause of action, which the court held should not be imposed unless ERISA expressly provides for it.<sup>82</sup> The distinction between "remedy" and "cause of action" is apparent from the court's willingness to incorporate common law trust remedies into ERISA, but not common law trust causes of action. For example, the *Nieto* court rejected the argument made by the Secretary of Labor in his amicus brief that prior cases had incorporated common law trust causes of action into ERISA.<sup>83</sup> The *Nieto* court ruled that while *Donovan v. Mazzola*<sup>84</sup> held that Congress intended courts to "draw on principles of traditional trust law"<sup>85</sup> in formulating remedies, it did not support the "far broader proposition . . . that the common law of trusts supplies a federal cause of action where the statute itself provides none."<sup>86</sup> Accordingly, the *Nieto* court did not incorporate a cause of action against non-fiduciaries even though such a cause of action was authorized by the common law of

78 Section 409(a) provides that a breaching fiduciary "shall be subject to such other equitable or remedial relief as the court may deem appropriate." See *supra* note 2 (emphasis added). Section 502(3)(b) provides that participants and beneficiaries may "obtain other appropriate equitable relief." See *supra* note 18 (emphasis added). Therefore, the very most that these sections authorize is "other equitable or remedial relief," with § 502 actually limited to only "equitable relief."

79 *Nieto*, 845 F.2d at 872.

80 *Freund v. Marshall & Ilsley Bank*, 485 F. Supp. 629, 641-42 (W.D. Wis. 1979); *McDougall v. Donovan*, 539 F. Supp. 596, 598 n.4 (N.D. Ill. 1982) ("In the absence of clear legislative history to the contrary, we can only assume that the broad, remedial enforcement authority . . . is intended to effectuate the broad and remedial purposes of ERISA.").

81 *Nieto*, 845 F.2d at 871. The Court in *Russell* also recognized that Congress clearly did not intend to authorize additional legal remedies (such as a cause of action against non-fiduciaries) under ERISA. The Court pointed to the fact that "an early version of the statute contained a provision for 'legal or equitable' relief . . . [but] [i]n the bill passed by the House of Representatives and ultimately adopted by the Conference Committee the reference to legal relief was deleted." *Massachusetts Mut. Ins. Co. v. Russell*, 473 U.S. 134, 145-46 (1985).

82 *Nieto*, 845 F.2d at 872.

83 *Id.*

84 716 F.2d 1226, 1235 (9th Cir. 1983).

85 *Id.* at 1231, 1235.

86 *Nieto*, 845 F.2d at 872 (emphasis added).

trusts.<sup>87</sup> However, the court did suggest the imposition of a common law trust remedy (constructive trust) upon property improperly received by the non-fiduciary.<sup>88</sup>

Traditionally, the concept of using a constructive trust to trace assets into the hands of third parties was considered an equitable remedy.<sup>89</sup> A constructive trust differs from a legal cause of action for aiding and abetting. In an action for aiding and abetting, the non-fiduciary is actually found liable for having committed a wrong and, as such, must pay the damages proximately caused.<sup>90</sup> In a tracing of assets through a constructive trust, however, a court would not specifically find that the non-fiduciary committed a wrong.<sup>91</sup> Rather, the court simply issues an order that the assets, wherever they may be, belong to the fund and must be returned. The court does not find the non-fiduciary guilty of any wrongdoing nor does it hold the non-fiduciary personally liable. As a result, a constructive trust is not only equitable, where aiding and abetting is legal; a constructive trust is also a remedy, where aiding and abetting is a cause of action.

#### IV. Constructive Trust as Authorized Equitable Relief

*Freund* and its progeny insisted that non-fiduciary liability under section 409(a) was necessary to provide effective remedies under ERISA.<sup>92</sup> *Nieto*, however, suggested that other remedies available within the complex scheme of ERISA might serve this purpose in place of non-fiduciary liability.<sup>93</sup> One of the court's suggestions, a constructive trust, could be

87 RESTATEMENT (SECOND) OF TRUSTS § 280 (1959) provides: "The trustee can maintain such actions at law or suits in equity or other proceedings against a third party as he could maintain if he held that trust property free of trust." See generally G. BOGERT, THE LAW OF TRUSTS AND TRUSTEES § 955 (2d ed. rev. 1978).

88 *Nieto*, 845 F.2d at 874.

89 G. BOGERT, THE LAW OF TRUSTS AND TRUSTEES § 471 (2d ed. rev. 1978).

90 The *Freund* court stated:

Under traditional principles of trust law a third party who assisted a trustee in committing a breach of trust could be held liable in an action brought by the beneficiary. Moreover, the trustee and the third party could be joined in a suit for the recovery of the value of the trust property lost on account of the breach.

*Freund*, 485 F. Supp. at 642 (citing G. BOGERT, THE LAW OF TRUSTS AND TRUSTEES § 868 (2d ed. rev. 1978)).

91 Although a finding of wrongdoing on the part of the non-fiduciary would not be required, a beneficiary seeking the imposition of a constructive trust may have to show that the non-fiduciary was not a bona fide purchaser. Bona fide purchasers take trust assets free of any claim by the trust's beneficiaries. See RESTATEMENT (SECOND) OF TRUSTS § 284 (1959). According to its definition, a person would not be considered a "bona fide purchaser" if he either had notice of the breach of trust or failed to give value.

A third party [non-fiduciary] has notice of the breach [of trust] not only when he knows of the breach [of trust], but also when he should know of it; that is when he knows facts which under the circumstances would lead a reasonably intelligent and diligent person to inquire whether the trustee is a trustee and whether he is committing a breach of trust . . .

RESTATEMENT (SECOND) OF TRUSTS § 297 comment a (1959). In addition, at common law, the receipt of trust assets by a third party resulting from a fiduciary breach constituted sufficient participation for purposes of establishing knowing participation. As a result, a non-fiduciary who aided and abetted a fiduciary in a breach of trust would clearly have sufficient notice, and would therefore not be considered a bona fide purchaser.

92 See, e.g., *McDougall v. Donovan*, 539 F. Supp. 596, 598 n.5 (N.D. Ill. 1982).

93 *Nieto*, 845 F.2d at 873.

used to achieve the same ends as non-fiduciary liability without violating either the language or the intent of ERISA.<sup>94</sup>

The legislative history of ERISA indicates that the "other equitable relief" provided for in section 502 may be derived from state trust law principles. In the House Conference Report, Senator Williams emphasized that remedies should be fashioned for ERISA violations in the same way that they are formulated under section 301 of the Labor Management Relations Act.<sup>95</sup> An overwhelming number of courts have held that section 301 "authorizes federal courts to fashion a body of federal law"<sup>96</sup> by "looking at the policy of the legislation and fashioning a remedy that will effectuate that policy."<sup>97</sup> Given the broad language of section 502 and the guidance provided by its legislative history, it appears that Congress intended to grant the courts wide-ranging powers to impose equitable relief that would carry out the Act's intended purpose—to "protect . . . the interests of participants in employee benefit plans and their beneficiaries."<sup>98</sup> Accordingly, while ERISA would not authorize a direct cause of action against a non-fiduciary,<sup>99</sup> courts could impose the state law remedy of constructive trust.<sup>100</sup>

A court could not impose a constructive trust, however, in all cases where a non-fiduciary misappropriated funds. Under section 502, equitable relief would only be available if the court found a violation of another section of ERISA or the terms of the plan.<sup>101</sup> For example, in *Nieto*, the court ruled that section 502 would apply only if the district court, on remand, found that the non-fiduciary party in interest had violated section 406.<sup>102</sup> Similarly, in *Freund*, the fiduciary's violation of section 409 would trigger the application of section 502. In either case, therefore, the courts could have imposed equitable relief in the form of a constructive trust.

If a court imposed a constructive trust, it would order the non-fiduciary to return the fund assets or proceeds from the sale of the assets to the

94 See *infra* note 104.

95 H.R. CONF. REP. NO. 1280, 93d Cong., 2d Sess. 327, reprinted in 1974 U.S. CODE CONG. & ADMIN. NEWS 5038, 5107. This report stated: "All such actions in Federal or State courts are to be regarded as arising under the laws of the United States in similar fashion to those brought under section 301 of the Labor Management Relations Act of 1947." *Id.*

96 *Textile Workers v. Lincoln Mills*, 353 U.S. 448, 451 (1957); see also *Association of Westinghouse Salaried Employees v. Westinghouse Elec. Corp.*, 210 F.2d 623, 625 (3d Cir. 1954), *aff'd on other grounds*, 348 U.S. 437 (1955); *United Elec., Radio & Mach. Workers v. Oliver Corp.*, 205 F.2d 376, 384-85 (8th Cir. 1953); *Textile Workers Union of Am. v. Arista Mills Co.*, 193 F.2d 529, 533 (4th Cir. 1951); *Hamilton Foundry & Mach. Co. v. International Molders & Foundry Workers Union*, 193 F.2d 209, 215 (6th Cir. 1951), *cert. denied*, 343 U.S. 966 (1952); *Shirley-Herman Co. v. International Hod Carriers Union*, 182 F.2d 806, 809 (2d Cir. 1950); *Schatte v. International Alliance*, 182 F.2d 158, 164 (9th Cir. 1950).

97 *Lincoln Mills*, 353 U.S. at 457.

98 29 U.S.C. § 1001(b).

99 See *supra* text accompanying notes 81-91.

100 One federal district court has exercised this power in the ERISA context. In *Donovan v. Schmoutey*, 592 F. Supp. 1361 (D. Nev. 1984), trustees were specifically alleged to have violated ERISA §§ 404 and 406 by making loans to non-fiduciary defendant borrowers who were contributors to the fund. In rendering judgment against the defendants, the court effectively imposed a constructive trust by ordering the restitution of the plan funds from the non-fiduciary borrowers.

101 29 U.S.C. § 1132(3); see *supra* note 18.

102 *Nieto*, 485 F.2d at 874.

plan. Thus, even if the non-fiduciary sold the assets to a bona fide purchaser for value, a court could still compel the non-fiduciary to reconvey the value received from the bona fide purchaser to the fund.<sup>103</sup> Because the constructive trust would restore fund assets or the proceeds from the sale of those assets regardless of where they might lie, a constructive trust would provide an effective remedy for plan participants and beneficiaries.<sup>104</sup>

## V. Conclusion

*Freund* and the courts which followed it were incorrect in stating that non-fiduciary liability was necessary in order to provide effective remedies under ERISA. The *Nieto* court correctly determined that the *Freund* court and the courts following it exceeded their authority in finding that a non-fiduciary could be liable for aiding and abetting under section 409(a). The plain language of section 409(a) provides a remedy only against fiduciaries. Also, Congress did not intend for the courts to supplement ERISA's complex scheme with state law causes of action. Finally, because a constructive trust (an equitable remedy that would be authorized under ERISA) could be used to achieve the same ends, non-fiduciary liability is not necessary to provide effective remedies to pension plan participants and beneficiaries. In the future, courts should follow the lead of *Nieto v. Ecker* and abandon the misguided approach of *Freund v. Marshall & Ilsley Bank*.

Kevin B. Bogucki  
Charles P. Cullen  
Judith Ann Hagley

103 (1) Where the trustee in breach of trust transfers trust property to a person who takes with notice of the breach of trust, the transferee can be compelled,

(a) if he has not disposed of the property, to restore it to the trust, together with the income which he has received from the property; or

(b) if he has disposed of the property, to pay the proceeds of the sale with the income received from the property and from the proceeds, or the amount of the proceeds with interest thereon and with any income which he received from the property before he sold it, or to pay the value of the property at the time of the decree with the income received from the property . . . .

RESTATEMENT (SECOND) OF TRUSTS § 291 (1959). In addition, comment (e) to section 291 provides that if the transferee with notice of the breach of trust "sells and has disposed of the proceeds or if the proceeds cannot be reached, the beneficiary can compel him to pay the amount of the proceeds with interest thereon, together with any income which he received from the property before he sold it."

104 Although a constructive trust would provide an effective remedy, it would not be as effective as a cause of action against the non-fiduciary because punitive damages could not be recovered under a constructive trust where they might be available in a § 409(a) cause of action. See *supra* note 2. Nonetheless, a constructive trust would not require the courts to go beyond the plain language or legislative intent of ERISA as in the case of a § 409(a) cause of action. See *supra* notes 45-66 and accompanying text.