



ERISA Fiduciary Responsibility and Liability

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Who Is A Fiduciary?

- ERISA section 3(21)(A) provides that a person is a fiduciary with respect to an employee benefit plan to the extent that such a person does any of the following:
 - Exercises any discretionary authority or control over the management of a plan, or over the management or disposition of plan assets;
 - Renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan; or
 - Has any discretionary authority or discretionary responsibility in the administration of such plan.
- ERISA defines “fiduciary” not in terms of formal title but rather in functional terms of control and authority over the plan.
 - Mertens v. Hewitt Assocs., 508 U.S. 248 (1993); Leigh v. Engle, 727 F.2d 113 (7th Cir. 1984); Yeseta v. Baima, 837 F.2d 380 (9th Cir. 1989) (individual was fiduciary since he exercised control, even though it was unclear whether he was authorized to do so); Employee Benefits Sec. Admin., Dep’t of Lab., Meeting Your Fiduciary Responsibilities (May, 2004) (fiduciary status is based on the functions performed for the plan, not just a person’s title) available at <http://www.dol.gov/ebsa/publications/fiduciaryresponsibility.html>.
 - Functional test is fact intensive. The focus of the inquiry is on the extent to which a person has any control or authority over the management or administration of an employee benefit plan or its assets.
 - Mertens v. Hewitt Assocs., 508 U.S. 248 (1993); Beddall v. State St. Bank & Trust Co., 137 F.3d 12 (1st Cir. 1998) (trustee bank is not a fiduciary to the extent it had no discretionary authority or control over investment of plan assets and no duty to monitor the investment manager retained by plan sponsor).
- Activities that give rise to fiduciary status include:
 - Appointing other plan fiduciaries;
 - Selecting and monitoring plan investment vehicles;
 - Selecting and monitoring third party service providers;
 - Interpreting plan provisions; and
 - Exercising discretion in denying or approving benefit claims.
 - In re Enron Corp. Sec., Derivative & ERISA Litig., 284 F. Supp.2d 511, (S.D. Tex. 2003) (under ERISA, a person or entity may be deemed a fiduciary either by assumption of the fiduciary obligations (the functional or defacto method) or by express

– designation by the ERISA plan; fiduciary status under ERISA is to be construed liberally, consistent with ERISA’s policies and objectives).

– ERISA section 402(a) requires each covered plan to provide for one or more “named fiduciaries” who jointly or severally shall have authority to control and manage the operation and administration of the plan.

– The term “named fiduciary” means a fiduciary who is named in the plan instrument or who pursuant to a procedure specified in the plan is identified as a fiduciary by a person who is an employer or employee organization.

– Plan documents commonly name the employer or an administrative committee as the named fiduciary.

– CSA 401(k) Plan v. Pension Professionals, Inc., 195 F.3d 1135 (9th Cir. 1999) (a plan must have at least one fiduciary named in the written plan).

– A person or entity that has the power to appoint, retain and/or remove a plan fiduciary from his or her position has discretionary authority or control over the management or administration of a plan and is a fiduciary to the extent that he or she exercises that power.

– Coyne & Delaney Co. v. Selman, 98 F.2d 1457 (4th Cir. 1996) (the power to appoint, retain and remove plan fiduciaries constitutes discretionary authority over the management of a plan); Liss v. Smith, 991 F. Supp. 278 (S.D.N.Y. 1998) (it is by now well-established that the power to appoint plan trustees confers fiduciary status).

What Are Settlor Functions Versus Fiduciary Activity?

- ERISA section 3(21)(A) provides that a person is a fiduciary only “to the extent” the person is performing a fiduciary function.
 - Pegram v. Herdrich, 120 S. Ct. 2143 (2000) (in every case charging a breach of an ERISA fiduciary duty, the threshold question is whether the person was acting as a fiduciary (that is, was performing a fiduciary function) when taking the action subject to the complaint).
 - Being a fiduciary is not an all or nothing proposition.
 - Beddall v. State St. Bank and Trust Co., 137 F.3d 12 (1st Cir. 1998); Johnson v. Georgia-Pacific Corp., 19 F.3d 1184 (7th Cir. 1994).
 - Relying on the “to the extent” limit, the Department of Labor and the courts have recognized a distinction between a “settlor” – business function, which is not subject to fiduciary provisions of ERISA and fiduciary activities.
 - Curtis - Wright Corp. v. Schoonejargon, 514 U.S. 73 (1995) (an employer, even though it may act as a fiduciary when it is administering its employee welfare benefit plan, is not engaged in plan administration and thus is not acting in a fiduciary capacity when it decides to create, amend, or terminate such a plan); Lockheed Corp. v. Spink, 517 U.S. 882 (1996) (same as to pension plans); Malia v. Gen. Elec. Co., 23 F.3d 828 (3d Cir. 1994) cert. denied, 513 U.S. 956 (1994) (fiduciary duties do not attach to business decisions related to modifications of the design of a pension plan and in such circumstances the plan sponsor is free to act as an employer and not a fiduciary).
- The most common settlor functions are “design” decisions involving:
 - (i) establishment of plan;
 - (ii) group of covered employees;
 - (iii) benefits to be provided; and
 - (iv) plan amendment or termination.
- Varity v. Howe, 516 U.S. 489 (1996); Amato v. W. Union Inc., 773 F.2d 1402 (2d Cir. 1985); Hozier v. Midwest Fasteners Inc., 908 F.2d 1155 (3d Cir. 1990); Trenton v. Scott Paper Co., 832 F.2d 806 (3d Cir. 1987), cert. denied, 485 U.S. 1022 (1988) (the determination of who would be eligible for an early retirement program was “purely a corporate management decision” and not subject to ERISA’s fiduciary obligations); Johnson v. Georgia-Pacific Corp., 19 F.3d 1184 (7th Cir. 1994) (the use of excess plan assets to provide increased benefits to active employees as a tool to fend off a hostile takeover was not a fiduciary decision).
- The implementation of a settlor decision may involve the exercise of discretion in plan administration and thereby be a fiduciary function. When same party is both settlor and fiduciary, court will closely scrutinize the action being taken.
 - Varity v. Howe, 516 U.S. 489 (1996); Amalgamated Clothing & Textile Workers Union v. Murdock, 861 F.2d 1406 (9th Cir. 1988).

– In Varity, the employer distributed materials and held a meeting in which it convinced employees to voluntarily transfer to a new subsidiary by intentionally misrepresenting the subsidiary's financial viability and the future security of the employees' benefits. The district court held that the employer was acting as a fiduciary in making these communications since the communications were about benefits and the Eighth Circuit and Supreme Court affirmed.

– Several cases have discussed the issue of whether a plan sponsor is acting in a settlor or fiduciary capacity when implementing a decision to spin-off its pension or welfare plans as part of a restructuring.

– Sengpiel v. B.F. Goodrich Co., 156 F.3d 660 (6th Cir. 1998), cert. denied, 526 U.S. 1016 (1999) (employer was not acting as a plan fiduciary in transferring its welfare plan liabilities to a new company formed as a result of a joint venture); Systems Council EM-3 v. AT&T Corp., 159 F.3d 1376 (D.C. Cir. 1998) (AT&T was not acting in a fiduciary capacity when it amended its pension and welfare plans and allocated the assets and liabilities of those plans between itself and its spun-off corporation).

What Is The Significance of Being A Fiduciary?

- Fiduciaries have important responsibilities and are subject to higher standards of conduct because they act on behalf of plan participants and beneficiaries.
 - ERISA section 404; Employee Benefits Sec. Admin., Department of Labor, Meeting Your Fiduciary Responsibilities (May, 2004) available at <http://www.dol.gov/ebsa/publications/fiduciaryresponsibility.html>.
 - Fiduciary responsibilities include:
 - Acting solely in the interest of plan participants and their beneficiaries and with the exclusive purpose of providing benefits to them;
 - Carrying out their duties prudently; and
 - Following the plan documents (unless inconsistent with ERISA).
 - Donovan v. Bierwirth, 680 F.2d 263 (2nd Cir. 1982), cert denied, 459 U.S. 1069 (1982) (given that a fiduciary's duties are the highest known to the law, a trustee is held to something stricter than the morals of the market place; fiduciaries are subject to three different although overlapping standards of ERISA section 404).

What Is The Duty of Loyalty?

- ERISA section 404(a)(1) provides that a fiduciary shall discharge his or her duties with respect to a plan solely in the interest of the participants and beneficiaries and for the exclusive purpose of providing benefits to participants and their beneficiaries.
- ERISA section 404(a)(1) is commonly referred to as the exclusive benefit rule and is considered to command a fiduciary's duty of undivided loyalty.
 - Donovan v. Bierwirth, 680 F.2d 263 (2d Cir. 1982), cert denied, 459 US 1069 (1982) (ERISA section 404(a)(1) requires that in discharging his or her fiduciary duties, a fiduciary act with an "eye single" to the interests of the plan's participants and beneficiaries).
 - Any form of self-dealing is clear breach of duty of undivided loyalty.
 - Lowen v. Tower Asset Management, 829 F.2d 1209 (2d Cir. 1987) (investment advisory firm invested significant portion of plan assets in companies in which advisory firm members had substantial equity interests); Brock v. Hendershott, 840 F.2d 339 (6th Cir. 1988) (fiduciary negotiated dental coverage as part of collective bargaining agreement with group with whom he had commission arrangement); International Brotherhood of Painters v. Duval, 925 F. Supp. 815 (D.D.C. 1996) (fund's financial consultant was stepson of trustee).
 - The duty of loyalty forbids a fiduciary not only from using plan assets for his or her personal interest but also from favoring the interests of a third party over the interests of a plan participant, even if the fiduciary's own interests are not implicated.
 - Officers of a corporation who are trustees of its pension plan do not violate their duties as trustees by taking action that is in the best interest of the participants and beneficiaries even though the action may incidentally benefit the corporation or themselves.
 - Siskind v. Sperry Retirement Program, 47 F.3d 498 (2d Cir. 1995) (ERISA plan fiduciaries were not prohibited from taking actions that incidentally benefit the employer); Lockheed v. Spink, 116 S. Ct. 1783 (1996).
 - The duty of loyalty requires that trustees avoid placing themselves in a position where their acts as officers or directors of the corporation will prevent their functioning with complete loyalty to participants.
 - 29 C.F.R. § 2550.408(c) (prohibitions are imposed upon fiduciaries to deter them from exercising the authority, control or responsibility which makes such persons fiduciaries when they have an interest which may conflict with the interests of the plans for which they act; a fiduciary may not use the authority, control or responsibility which makes such person a fiduciary to cause a plan to pay an additional fee to such fiduciary (or to a person in which such fiduciary has an interest which may affect the exercise of such fiduciary's best judgment as fiduciary)).
 - The duty of loyalty may require that a fiduciary disclose material information that the fiduciary knows the participant does not have and will need in order to make an informed decision.

– Eddy v. Colonial Life Insurance Co., 919 F.2d 747 (D.C. Cir. 1990) (duty of loyalty may impose a duty to speak without being asked -- the duty to disclose material information is the core of a fiduciary's responsibility); Bixler v. Central PA Teamsters Health and Welfare Fund, 12 F.3d 1292 (3d Cir. 1993) (this duty to inform is a constant thread in the relationship between beneficiary and trustee; it entails not only a negative duty not to misinform, but also an affirmative duty to inform when the trustee knows that silence might be harmful).

– In re Enron Corp. Securities, Derivative & ERISA Litigation, 284 F. Supp. 2d 511 (S.D. Tex 2003) (the most fundamental duty of ERISA plan fiduciaries is a duty of complete loyalty, to insure that they discharge their duty solely in the interests of the participants and beneficiaries and to exclude all selfish interest and all consideration of the interests of third persons).

What Is The Prudence Standard?

- ERISA section 404(a)(1)(B) provides that a fiduciary must act “with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.”
- ERISA section 404(a)(1)(B) is commonly referred to as the “prudent person rule.” This rule means that a fiduciary’s actions will be compared against those of a hypothetical prudent person.
- Although investment decisions are often the basis for suits alleging violation of the prudent person standard, all fiduciary actions are held to the same standard of prudence.
- Whether a fiduciary acted prudently in any given situation depends on the facts and circumstances of each case. The scope of the fiduciary’s duty of prudence is limited to those factors and circumstances that a prudent person having similar duties and familiar with such matters would consider relevant.
- 29 C.F.R. § 2550.404a-1(b)(1) (a fiduciary must give “appropriate consideration” to the facts and circumstances that the fiduciary knows or should know are relevant to the particular investment, including the role that the investment plays in the plan’s investment portfolio; fiduciary must act in accordance with the conclusions that were reached after the appropriate consideration).
- 29 C.F.R. § 2550.404a-1(b)(2) (with respect to investment decisions, the concept of “appropriate consideration” includes a determination by the fiduciary that a particular investment or investment course of action is reasonably designed to further the purposes of the plan, taking into consideration the risk of loss and the opportunity for gain associated with such investment; consideration should also be given to (1) the diversification of the investment portfolio, (2) the liquidity of the investment in relation to the liquidity needs of the plan, and (3) the projected investment return in relation to the funding objectives of the plan).
- Courts have interpreted the prudent person rule to focus on the conduct of the fiduciary, the extent of the fiduciary’s diligent investigation and performance of acts consistent with the purpose of the plan. This is the doctrine of “procedural prudence.”
- GIW Industries Inc. v. Trevor, Stewart, Burton & Jacobsen, Inc., 11 Employee Benefits Cas. (BNA) 2737 (11th Cir. 1990) (the ultimate outcome of the investment is not the yardstick by which the prudence of the fiduciary is measured; the court must consider the conduct of the fiduciary not the success of the investment, and the court must evaluate the fiduciary’s conduct at the time of the investment decision rather than from the vantage point of hindsight); Donovan v. Mazzola, 716 F.2d 1226 (9th Cir. 1983) (the test for prudence was whether the individual trustees, at the time they engaged in the challenged transactions, employed the appropriate methods to investigate the merits of the investment and to structure the investment).

– Whether ERISA’s standard of prudence has been breached often depends on whether the fiduciary can demonstrate that it engaged in procedural due diligence before taking the questioned action.

– In re Unisys Savings Plan Litigation, 173 F.3d 145 (3d Cir. 1999) (plan’s investment committee did not breach its ERISA fiduciary duty to plan participants in connection with the purchase of guaranteed insurance contracts for the plan even though the issuing insurance company (Executive Life Ins. Co.) later failed and was put into conservatorship; the fiduciaries were not held to be guarantors of the investment because they proved that they had undertaken a reasonable investigation of the investment option -- including the retention of an outside consultant versed in this type of investment); U.S. v. Mason Tenders Dist. Counsel of Greater N.Y., 909 F. Supp. 882 (S.D.N.Y. 1995) (trustees were imprudent in real estate purchase because trustee failed to obtain valuation or appraisal and failed to participate in any negotiations of the purchase price); Scardelletti v. Bobo, 897 F. Supp. 913 (D.Md. 1995) (trustee breached fiduciary duty when following the advice of actuary because trustee did not assure that actuary was competent and recommendations based on accurate and current information); Whitfield v. Cohen, 682 F. Supp. 188 (S.D.N.Y. 1988) (in order to make prudent selection of investment manager, trustee must consider (i) qualifications, (ii) reasonableness of fees, (iii) relationship to be entered into and (iv) providing for adequate periodic review).

What Is The Duty of Disclosure?

– Generally: The duty to disclose material information is the core of a fiduciary’s responsibility, animating the common law of trusts long before the enactment of ERISA. At the request of a beneficiary (and in some circumstances upon his own initiative), a fiduciary must convey complete and correct material information to a beneficiary.

– Once a participant or beneficiary makes an inquiry, a fiduciary has a duty to make “correct and complete material information” available to the participant or beneficiary. Eddy v. Colonial Life Ins. Co., 919 F.2d 747 (D.C. Cir. 1990).

– Eddy case suggests loyalty may impose a duty to speak without being asked.

– Misrepresentation about Benefits

– Varity Corp. v. Howe, 516 U.S. 489 (1996) - Employer/Plan Administrator misled participants when it said that a transfer from one company to an affiliated company would not significantly undermine the security of ERISA-protected employee benefits.

– Varity suggests fiduciaries may have a duty to disclose truthful information on their own initiative. It is well established that a plan administrator acts in a fiduciary capacity when it explains plan benefits, even likely future benefits, to its employees.

– Pegram v. Herdrich, 120 S. Ct. 2143 (2000). The Supreme Court’s dicta picks up where Varity leaves off: “it could be argued that ... [a fiduciary] is obligated to disclose characteristics of the plan and of those who provide services to a plan, if that information affects beneficiaries’ material interests.”

– Disclosure upon Inquiry

– Krohn v. Huron Memorial Hospital, 173 F.3d 542 (6th Cir. 1999). Krohn, a nurse, was injured and her husband requested information regarding benefits from the hospital. The employer hospital breached its duty of disclosure when it failed to provide information about long-term disability benefits at the time Krohn’s husband requested information.

– Bins v. Exxon Co., 2000 WL 1126387 (9th Cir. 2000). An employee heard a rumor that the plan was going to change and offer a lump-sum distribution. The Ninth Circuit Court held that a fiduciary must disclose possible changes to a plan under “serious consideration” and found “serious consideration” was present where there was:

– a specific proposal,

– being discussed for purposes of implementation,

– by senior management with the authority to implement the change.

– Disclosure in the Absence of Inquiries

- Jordan v. Federal Express Corp., 116 F.3d 1005(3d Cir. 1997) (participant’s failure to inquire specifically about the issue of irrevocability of benefits elections did not preclude lawsuit for breach of duty of disclosure).
- Interaction of SEC and ERISA Disclosure Requirements
 - In re Enron Corp. Sec., Derivative & ERISA Litig., 284 F. Supp.2d 511, 555 (S.D. Tex. 2003), describes the duty of disclosure under ERISA as “an area of developing and controversial law.” The controversies play out in the cases below...
 - Judge Harmon rejected Enron executives’ argument that a conflict between federal securities laws and ERISA provided a viable excuse for failure to disclose. Judge Harmon ruled that the statutes should be construed to require disclosure of material financial status to the investment public generally, including plan participants...because continued silence and deceit only encourages the alleged fraud and increases the injury. See In re Enron, 284 F. Supp.2d at 565-67; James T. Herod & Tara E. Silver-Malyska, The District Court’s First Decision in Enron: Implications and Guidance for Retirement Plan Fiduciaries, 17 Benefits L. J. 23, 27 (2004)
 - Caselaw establishes that compliance with SEC regulations does not rule out the possibility of ERISA fiduciary breaches.
 - Lalonde v. Textron, 369 F.3d 1 (1st Cir. 2004) (overturning lower court because the factual record was insufficient to rule out the possibility that the directed fiduciary was not free to disclose that employer stock might not be in best interests of ESOP participants).
 - Moench v. Robertson, 62 F.3d 553 (3d Cir. 1995) (remanding for consideration of whether fiduciary of ESOP should have stopped investing in employer stocks. Fiduciary duty may require deviation from the Plan).
 - In re Sprint Corp. ERISA Litig., 2004 WL 1179371, 33 Employee Benefits Cas. (BNA) 1287 ((D. Kan. 2004) (denying motion to dismiss because court rejects fiduciaries’ argument that SEC filings can not be a basis for fiduciary liability when the filings were incorporated into the plan SPD). The court also rejected the fiduciaries’ argument that trying to comply with ERISA § 404(c) by incorporating filings should provide a safe harbor. The court decides that § 404(c) provides a way to avoid liability for losses on participant-directed investments, but does not cure a fiduciary breach.
 - In re Xcel Energy, 312 F. Supp.2d 1165 (D. Minn. 2004). Court holds that ERISA plan fiduciaries cannot use securities laws to shield themselves from potential liability for breach of fiduciary duties.
 - In re Sears ERISA Litigation, 2004 WL 407007, 32 Employee Benefits Cas. (BNA) 1699 (N.D. Ill. 2004). Sears misstated its financial health and stability in SEC filings. The investment committee knew -- specific allegations of actual knowledge were made by the plan participants -- that the company was having financial difficulty and knowingly disseminated false information. The court would not dismiss on the ERISA fiduciary duty question even though Sears took steps to assure SEC compliance.



– Stein v. Smith, 270 F. Supp.2d 157 (D. Mass. 2003). The Court denied defendants’ motion to dismiss on fiduciary claims where plan fiduciaries didn’t diversify ESOP and 401k investments or disclose large losses from underbidding on fixed-price contracts. Defendants claimed that the plan participants didn’t sufficiently plead fraud on the securities issue, but the court said that was not dispositive for fiduciary claims.

What Is The Duty To Monitor?

- Generally, the act of selecting plan service providers is an exercise of discretion over the management or administration of the plan or its assets. Thus the person selecting the service provider is a fiduciary within the meaning of ERISA and subject to ERISA’s fiduciary standards. See Batchelor v. Oak Hill Medical Group, 870 F.2d 1446 (9th Cir. 1989).
- A fiduciary can be held liable for the acts or omissions of his delegate if he has knowledge of a breach of fiduciary duty by the latter. ERISA § 405. Accordingly, a fiduciary must always be ready to step in and reassume a delegated function on behalf of the best interests of the plan and participants/beneficiaries.
- For this reason, contracts for service providers should permit termination by a plan without penalty on reasonably short notice, so that a plan is not locked into an arrangement that is disadvantageous. 29 C.F.R. § 2550.408b-2(c).
- After selection, the fiduciary is under a continuing duty to monitor the service provider’s performance; to review and evaluate, at reasonable intervals, the performance of others to whom responsibilities are delegated. The review should be done in a manner that may be reasonably expected to ensure that the performance of the responsible individuals comply with the terms of the plan and all statutory standards, including ERISA’s exclusive-benefit, prudence, diversification, and prohibited-transaction rules. 29 C.F.R. § 2509.75-8.
- In re Unisys Savings Plan Litigation, 22 Employee Benefits Cas. (BNA) 2945 (3d Cir. 1999) (procedural prudence in maintaining contemporaneous records of what a fiduciary is going to do, what a fiduciary is doing, and what a fiduciary has done supported Unisys, and helped the employer avoid liability).
- Martin v. Murphy, 16 Employee Benefits Cas. (BNA) 1767 (S.D. Fla. 1993) (fiduciaries must determine the reasonableness of compensation paid to a plan service provider).
- In Arakelian v. National Western Life Insurance Co., 755 F. Supp. 1080 (D.D.C. 1990), trustees argued they were not liable as fiduciaries because they had delegated plan administration to the insurance company from which they purchased a group annuity contract, and so never exercised fiduciary powers over the administration of the plan. The court held: “The fact that all administrative functions of the Plan were delegated to the Plan administrator (National Western) did not and does not absolve the trustees of their duty to review and insure that the administrator was acting in the best interests of the participants.”
- In Whitfield v. Cohen, 682 F. Supp. 188 (S.D.N.Y. 1988), the court held that the fiduciary “had a duty to monitor [the investment manager’s] performance with reasonable diligence and to withdraw the investment if it became clear or should have been clear that the investment was no longer proper for the Plan.”
- Cohen facts are illustrative: the fiduciary never received information about the nature of the investments (only amount invested, accrued interest, and sum of those two amounts). The dearth of information should have put the fiduciary on notice that further investigation and inquiry were necessary.



– How to Monitor:

– Establish and follow a formal review process at reasonable intervals to decide if (employer/plan administrator) wants to continue using the current service providers or look for replacements. Employee Benefits Sec. Admin., Department of Labor, Meeting Your Fiduciary Responsibilities (May, 2004) available at <http://www.dol.gov/ebsa/publications/fiduciaryresponsibility.html>.

- review the service providers' performance
- read any reports they provide
- check actual fees charged
- ask about policies and practices
- follow up on participant complaints

– Scardelletti v. Bobo, 897 F. Supp. 913 (D. Md. 1995) (trustees breached their duty when following the advice of an actuary because they trusted the actuary's recommendations for changing the formula of COLA without examining the actuarial assumptions that were relied upon).

How To Select Plan Fiduciaries?

– Historical practice of naming “the company” as the plan administrator in an attempt to shield individual directors and officers from liability has been ineffective. Courts have found that employees, officers and directors, regardless of their title, who perform fiduciary functions are fiduciaries.

– If the company is a fiduciary, the Department of Labor’s theory that the duty to appoint gives rise to an ongoing fiduciary duty to disclose creates a question whether any information known to the employer must be shared with other plan fiduciaries.

– If the company is a fiduciary, there is a question whether various company statements about the company’s outlook such as those in SEC filings, are construed as statements of an ERISA fiduciary.

– Naming the company as a fiduciary may also expose all individuals who act on behalf of the company to fiduciary liability - this includes the board of directors and top officers of the company.

– Variety v. Howe, 516 U.S. 489 (1996) (an employee of the plan sponsor could be construed as acting on behalf of the plan sponsor in the employer’s fiduciary capacity if a participant reasonably believed it to be so).

– Many companies struggle with whether to designate the board of directors or a non-board committee as the plan administrator or named fiduciary. Possible advantages of non-board committee include:

- More time and attention to devote to plan issues;
- Individuals with relevant expertise and knowledge of plans;
- Over time will establish working relationships with experts, consultants and specialized legal counsel that will enable it to address detailed and technical plan issues;
- Better positioned to monitor other appointed fiduciaries and service providers; and
- Possibly avoid issues related to insider knowledge involving plans that contain employer securities.

– Creating a committee populated with individuals who are top officers may still leave duty to disclose. Better alternative is to create committee of competent, non-top level employees. Object is to create a “Chinese Wall” between plan committee members and top officers. This approach will only work if committee members are not appointed by top officers or board members with duty to monitor and disclose.

What Special Issues Are Raised By Investing In Employer Stock?

- To ensure that the assets of pension funds are diversified beyond the assets of the company itself, Congress limited the amount of employer stock that may be held in a defined benefit plan to 10% of plan assets. ERISA § 407(a).
- Generally, plans may invest in employer securities so long as they qualify under Section 407. “Qualified Employer Securities” are defined in that section as:
 - stock, a marketable obligation, or an interest in a publicly traded partnership. ERISA § 407(d)(5).
 - In addition, the plan may not own more than 25% of the aggregate amount of stock of the same class issued and outstanding, and at least 50% of the aggregate amount outstanding must be owned by persons independent of the issuer. ERISA § 407(f)(1)
- ERISA § 404(a)(2) however provides that in the case of an eligible individual account plan the diversification requirement and the prudence requirement (only to the extent that it requires diversification) is not violated by acquisition or holding of qualifying employer real property or qualifying employer securities.
- Eligible individual account plans may invest up to 100% in qualifying employer securities.
- If a plan offers company stock as an investment option or makes matching contributions with company stock, the fiduciary must make a disinterested assessment as to whether the stock is an appropriate investment for the plan’s participants.
- When deciding to invest in employer securities, an ESOP fiduciary (like any other plan fiduciary) is governed by the exclusive purpose test and prudence test. This is so even where the plan document specifies that a certain amount of the plan’s assets will be invested in employer securities. See Eaves v. Penn, 587 F.2d 453 (10th Cir. 1978).
- Congress may have intended to encourage the formation of ESOPs, but it also imposed duties on ESOP fiduciaries to safeguard the interests of participants and beneficiaries. See Donovan v. Cunningham, 716 F.2d 1455 (5th Cir. 1983) (following Eaves).
- Courts have recognized that fiduciaries may invest in employer securities when the investment complies with the exclusive purpose rule and is not clearly *imprudent*. See Ershick v. Greb X-Ray Co., 705 F. Supp. 1482 (D. Kan. 1989); see also Schoenholtz v. Doniger, 628 F. Supp. 1420 (S.D.N.Y. 1986) (finding that the trustees were required, under § 404(a)(1)(D), to follow the Plan’s requirements for investing in employer securities, but that defendants’ self-interest led to a breach of their duty to act with the skill, prudence, and diligence required by the ERISA section).
- ERISA § 404(c) “Employee-Directed Plans” relieve plan fiduciaries of responsibility for investment losses that result from the participants’ investment decisions.

- Plan qualifies if it provides the participant (1) the opportunity to exercise control over the assets in his or her account, and (2) the opportunity to choose from a broad range of investment alternatives. 29 C.F.R. § 2550.404c-1(b)(1).

- If a fiduciary conceals or misrepresents material non-public facts, the participant is not capable of exercising independent control.

- However, the act of designating investment alternatives in an ERISA Section 404(c) plan is a fiduciary function to which the limitation on liability provided by Section 404(c) is not applicable. All of the fiduciary provisions of ERISA remain applicable to both the initial designation of investment alternatives and investment managers and the ongoing determination that such alternatives and managers remain suitable and prudent investment alternatives for the plan. Therefore, the particular plan fiduciaries responsible for performing these functions must do so in accordance with ERISA.

- Fiduciary Breaches with Respect to Investment in Employer Stock

- When the employer's stock suffers a precipitous decline in value, the loss of savings can trigger claims that the fiduciaries breached their duties by allowing the plan to continue buying company stock, permitting employer stock to remain an investment alternative for self-directed plans, failing to sell, etc., as financial conditions deteriorated.

- Cases on Fiduciary Breach with Respect to Employer Stock

- Kolar v. Rite Aid Corp., E.D. Pa. 01-cv-1229 (May 2002). [Settled] Securities class action alleged that trustees engaged in a scheme to manipulate the price of Rite Aid stock and knew or should have known that unregistered shares were sold to participants in violation of securities law. ERISA complaint asserts that defendants breached their duties by providing inaccurate and misleading information and failing to provide accurate information.

- Whetman et al. v. IKON Office Solutions, Inc., E.D. Pa, Docket No. 00-87 (May 2002). [Settled] Plaintiffs claim plan fiduciaries violated ERISA by improperly encouraging employees to invest in IKON stock, engaging in improper conduct which damaged the value of the stock, and failing to provide accurate and complete information about the Plan.

- Reinhart v. Lucent Technologies, No. 01-3491 (D.N.J. 2004) [Settled]. ERISA complaint alleged that directors/plan committees knew of problems at Lucent that made the stock an inappropriate investment. Specific allegations: misleading information, failing to provide accurate information, failing to adequately investigate the merits of investment in Lucent stock, and acting under a conflict of interest by continuing to offer Lucent stock.

- In re Stone & Webster, Inc., No. 00-02142 (RR) (D. Del. 2002) Following S&W bankruptcy, Department of Labor claims (1) ESOP fiduciaries had a duty to allocate S&W stock held in the suspense account notwithstanding the fact that it secured the unrepaid ESOP loan, (2) the savings plan fiduciaries should have ceased making the employer match in S&W stock at some time before the bankruptcy, and (3) the pension plan fiduciaries should not have made investments in S&W stock in the year before bankruptcy filing.

- In re Enron Corp. Sec., Derivative & ERISA Litig., 284 F. Supp.2d 511, 555 (S.D. Tex. 2003). Alleged breaches included: (1) maintaining company stock as an



investment option under the plan after it had become inappropriate to do so, (2) providing misleading information to participants regarding the financial condition of the company, (3) failing to provide participants with prospectus disclosure required by securities law, (4) making matching contributions in employer stock, (5) imposing a “black-out period” which prevented participants from disposing of company stock during a period of sharp decline in value, (6) failing to give notice of the “black-out.”

– Hull v. Policy Management Systems Corp., No. 3:00-778-17 (D. S.C. 2001). Employer matches in 401k plan were invested in employer stock, which dropped in value. Securities fraud action ensued, but ERISA claims were dismissed. Reason: company insiders who perpetuated securities fraud were not fiduciaries, fiduciaries were not alleged to have participated in the fraud and did not purchase stock at higher than prevailing market price (“innocent” plan fiduciaries may rely on market pricing).

How Can You Limit Fiduciary Liability?

- Create Good Plan Governance: Discrepancies between plan terms and actual governance structure and decision-making processes are very common. Many plan documents name an entity such as the corporation or board of directors to a fiduciary role, when decisions are actually made by others.
 - Inconsistencies lead to exposure for both “named fiduciaries” (who are failing to fulfill fiduciary role and failing to monitor “functional fiduciaries”) and for “functional fiduciaries” (who are unknowingly acting as fiduciaries without proper understanding of fiduciary duties and responsibilities).
 - Properly distinguish between fiduciary functions and settler functions. Although ERISA permits individuals to wear two hats, in practice this creates confusion. Better practice may be to establish “settler committee” and “fiduciary committee.”
- Limit Fiduciary Actions: It is clear that a fiduciary who delegates its duties to another has a duty to monitor the performance of its appointees. However, if plan document designates by position the members of the fiduciary committee rather than having individuals appointed by board of directors, there is an argument that establishment of fiduciary committee is a settlor function and not a fiduciary function.
 - Undertake Fiduciary Audit: Review authorizing board resolutions, plan documents, summary plan descriptions, committee charters, records/minutes of fiduciary actions and third-party contracts. Where inconsistencies are identified, amendments and corrective actions should be adopted.
 - Review employer’s ERISA fiduciary and D&O policies to assure proper coverage. Confirm that employer’s indemnification provisions (typically contained in corporate bylaws and resolutions) are aligned with the terms of its ERISA fiduciary and D&O policies. Confirm that employees who are neither members of the board of directors nor officers of the corporation are protected by indemnification and the terms of insurance policies.
- Consider if company stock funds are worth the risk. Since Enron there has been an onslaught of class action cases alleging fiduciary breaches relating to the offering of employer stock.