HR Law/Employee Benefits

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Lessons for Retirement Plan Fiduciaries Following Recent ERISA Litigation

As a result of the highly publicized financial decline of several companies' retirement plans, courts are examining the actions of companies and plan fiduciaries with increasing scrutiny. Plan fiduciaries are again reminded that they cannot simply manage their retirement plans on "autopilot."

Recent Litigation

The U.S. Department of Labor (DOL) recently received court approval of its $134 million settlement to be paid to workers and retirees of Enron Corp. The settlement resolves both the DOL's creditor claim in Enron's pending Chapter 11 bankruptcy and its private class action, which was filed in 2003.[1] The DOL's lawsuit alleged, among other things, that former executives Kenneth L. Lay and Jeffrey K. Skilling, and other Enron executives and members of the plan's administrative committees, imprudently retained Enron stock as an investment option for its retirement plans given its faltering financial condition.

Courts continue to hold plan fiduciaries to the standards of fiduciary duty with respect to the management of 401(k) stock funds as with respect to other plan investments. For instance, plaintiffs reached a proposed $11.75 million settlement with former officers and directors of Kmart who had invested employee pension funds in company stock with falling prices despite alleged knowledge by these individuals that the company was headed toward bankruptcy.[2] Similarly, a $5.25 million settlement was reached between UAL Corporation ESOP Committee and plan participants[3] in 2005 to settle allegations about UAL's employee stock ownership plan's loss of $2 billion due to the collapse of UAL stock following the September 11, 2001 terrorist attacks. Additionally, WorldCom and its directors and officers reached a $47 million settlement with its plan participants to resolve allegations of fiduciary duty violations for failing to disclose the company's financial situation to the participants.[4]

LESSONS FROM RECENT CASES

Executives as Plan Fiduciaries

Executives who are also plan fiduciaries must remember that they may have dual loyalties — to plan participants and to shareholders — and do not have reduced fiduciary obligations. When communicating with plan participants about the plan, an executive may be presumed to act as a fiduciary, and not as a company executive. It is important that executives understand their duties when they are acting in each respective role.

Oversight Responsibility

Because the allocation and delegation of fiduciary responsibilities are fiduciary acts, the act of appointing plan fiduciaries includes a duty to ensure that the appointed fiduciary understands and is able to perform the appointed functions.

Moreover, the board, committee or executive who makes fiduciary appointments has a duty to monitor the performance of the fiduciary.

Furthermore, the duty to monitor may become a duty to replace the appointed fiduciary, just as the duty to monitor investments has a concurrent duty to replace, where appropriate.

Prudent Management Is Crucial

Plan fiduciaries are encouraged to review and evaluate plan investments on a regular basis. They should continue to assess the reasons that particular investments – including company stock – are offered.

[1] *Chao v. Enron*, S.D. Tex., No. H-03-2257 (settlement announced February 16, 2006).
[2] *Rankin v. Rots*, E.D. Mich., No. 2:02CV71045 (settlement preliminarily approved February 9, 2006).
[3] *Summers v. UAL Corp. ESOP Committee*, N.D. Ill., No. 03-C-1537 (settlement approved October 12, 2005).
[4] *In re WorldCom, Inc. ERISA Litigation*, 345 F. Supp.2d 423 (S.D.N.Y. 2005).

Proper and Adequate Communications with Participants

Communicating with plan participants about plan benefits or investment options is a fiduciary function. Therefore, nonfiduciary executives should refrain from making statements that could be perceived by plan participants as an intent to influence participant investment behavior.

Separate and apart from investment advice is investment education. The DOL has issued a regulation that differentiates the fiduciary funtion of providing investment advice from the non-fiduciary function of providing investment education. Such education can reinforce fundamental concepts, such as the importance of diversification. Plan fiduciaries may consider obtaining an outside consultant or vendor to provide investment education programs.

Duty to Disclose Information

Duty to Disclose Potential Plan Changes

With respect to the duty to disclose potential plan changes, most jurisdictions apply the "serious consideration" standard. This standard provides that a duty of disclosure begins when a specific proposal is discussed for purposes of implementation by senior management with the authority to implement the change.[5] On the other hand, a minority of jurisdictions apply the "materiality" standard, which provides that a fiduciary who makes "material" misrepresentations about future benefits could be held liable for a breach of ERISA's fiduciary obligations.[6]

Under both standards, plan fiduciaries have an obligation to avoid misleading plan participants about various investments and proposals being considered. If plan participants question plan fiduciaries about various investments or proposals, the plan fiduciaries should provide accurate responses and avoid misrepresenting the status of any investments or proposals currently under consideration.

Is There a Duty to Disclose Nonpublic Company Information?

In *Pennsylvania Federation v. Norfolk Southern Corp.*,[7] the court held that plan fiduciaries are not required to disclose material nonpublic information solely to plan participants, which would essentially amount to insider trading, unless they are engaged in fraud.

On the other hand, in *In re Honeywell ERISA Litigation*,[8] the court refused to dismiss plaintiffs' case against plan fiduciaries despite defendants' arguments that imposing a duty of disclosure on plan fiduciaries would be inconsistent with securities laws.

The DOL advocates, and some courts have adopted, the approach that any nonpublic information that must be disclosed to satisfy fiduciary obligations under ERISA also constitutes "material nonpublic information" for which there is a duty of disclosure under federal securities laws. This approach negates the issue of whether complying with ERISA disclosure obligations would result in prohibited insider trading. However, at least one court has suggested that such disclosure would "simply have accelerated the demise of the [company] stock," making disclosure contrary to the fiduciaries' duty to avoid losses to the plan.[9]

Process, Process, Process

Procedural prudence is a key to minimizing risks of fiduciary breach. Although recent cases have often focused on the duty of prudence in the context of the investment in the stock of the plan sponsor, procedural prudence is critical to complying with the many duties imposed by ERISA.

Attorneys in the Employee Benefits Practice at Gardner Carton & Douglas LLP continually monitor the ever-evolving laws, regulations and standards pertaining to the responsibilities of plan fiduciaries and can assist a variety of organizations and fiduciaries with these issues. If you have any questions regarding plan fiduciary obligations, please contact any member of our Employee Benefits Practice on the following page.

[5] *Fischer v. Philadelphia Electric Co.*, 96 F.3d 1533, 1539 (3d Cir. 1996).
[6] *Beach v. Commonwealth Edison Co.*, 388 F.3d 1133 (7th Cir. 2004).
[7] 2004 WL 2315795 (E.D. Pa. 2004).
[8] 2004 U.S. Dist. Lexis 21585 (D. N.J. 2004).
[9] *Cokenour v. Household Int'l, Inc.*, 32 E.B. Cas. 1783 (N.D. Ill. 2004).

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