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How to avoid liability in ERISA fiduciary litigation

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Just when the headaches of Sarbanes-Oxley have begun to dissipate, another ailment is afflicting those in upper management.

Welcome to the world of ERISA lawsuits – and we don't mean claims for the payment of a hernia operation. The class action plaintiffs' bar is focusing on the executive suite, accusing board members and senior management of breaching ERISA's fiduciary obligations to make sure their pension plans are operating prudently.

The growth of these lawsuits has its genesis in the difficult market earlier this decade. Adding fuel to the fire was the parallel spotlight on corporate fraud and poor management.

With every new securities investigation came the possibility of a tandem lawsuit under ERISA claiming that senior management and the board misled savings plan participants about the prudence of selecting and holding company stock as a plan investment. The theory apparently went that if there is a lawsuit to be had by outside shareholders, then there must be one for inside shareholders as well.

The mindset of the ERISA plaintiffs' bar is not hard to decipher. What better way to get the attention of the CEO or the general counsel and extract a settlement, than to name members of the board as defendants in an ERISA breach of fiduciary duty lawsuit.

No company wants its top people exposed to litigation, let alone the possibility of personal liability, as ERISA expressly allows. Also, naming board members and senior management as defendants will likely trigger multi-million dollar D&O or ERISA fiduciary insurance policies.

Who is administering the plan?

So what puts senior management in the ring and how can you avoid it? Very simply: Protect your executives from any reasonable notion that they are fiduciaries in charge of administering a plan. That is the fundamental premise required for these cases to pass muster with the courts and avoid early dismissal.

An ERISA lawsuit alleging a breach of fiduciary duty can only be brought against a fiduciary. That is where the analysis must start. Many cases have been thrown out of court soon after filing on this basis alone, i.e., the defendants were not fiduciaries.

Avoiding fiduciary status is not always easy. The board or CEO typically appoints the members of the plan committees who oversee administration. In those cases where courts refuse to dismiss board members or the CEO, the judges typically agree with plaintiffs' counsel that by virtue of

such appointments, those individuals have an ongoing duty to monitor, and hence, are fiduciaries themselves.

Courts have been mixed on their acceptance of this monitoring duty.

Those refusing to dismiss these defendants early on generally find that whether a defendant is an ERISA fiduciary largely depends on the facts, as ERISA itself defines “fiduciary” as a person who (i) exercises discretionary authority or control respecting management of a plan, (ii) renders investment advice for a fee, or (iii) has discretionary authority for plan administration. The argument is that ERISA’s definition of fiduciary can only be examined in “functional” terms of control over the plan.

This generally means that a plaintiff must show that the defendant is a fiduciary for the particular activity at issue in the case. The plaintiffs’ argument is easier if the plan documents identify the named defendant as a fiduciary.

If the plan does not identify the particular individual as a fiduciary, the court will often look to the pleadings to determine whether the plaintiff has sufficiently pled a connection between the individual and the particular activity challenged.

For instance, in the well-publicized WorldCom case, the court rejected the argument that directors’ power to appoint and monitor fiduciaries necessarily makes the directors fiduciaries. The court said the argument would “make any supervisor of an ERISA fiduciary also an ERISA fiduciary.... [There is] no statutory or decisional support for that proposition.”

In contrast, in the K-Mart case, the Eastern District of Michigan declined to dismiss the board members who appointed the plan fiduciaries.

Additional problem

An additional problem arises where the company is named as the plan fiduciary in the documents. Plaintiffs then claim that the directors are fiduciaries because the company acts through its board.

While the court in Enron accepted this reasoning, more recent cases have not. The current trend is for courts to require plaintiffs to plead facts showing that the directors individually exercised discretionary authority and not just acted as an arm of the company.

Courts generally have taken a similar approach for officer defendants. While corporate law often exempts officers from personal liability for the decisions of their company, that exemption does not apply in ERISA fiduciary cases, where the statute provides for individual fiduciary liability.

A common scenario in plan design is that officers are appointed to an administrative committee, and the committee itself is a named plan fiduciary in the plan documents. A typical administrative committee will involve the chief financial officer and the vice president of human resources. By virtue of sitting on the committee, these individuals become fiduciaries.

A related but more complicated issue is whether a company officer is wearing a “fiduciary hat” when making decisions that affect an ERISA plan. ERISA does not require that day-to-day corporate business transactions having a collateral effect on employee benefits be performed solely in the interest of plan participants.

But courts have inconsistently applied this principle, blurring the line between corporate and fiduciary decisions. Knowledge of company affairs not publicly known presents an even greater predicament for those administering plans, and the Department of Labor has muddied the waters further by successfully arguing in Enron that securities laws do not permit plan fiduciaries to keep non-public material information from plan participants.

Favorable trends

While the current legal landscape for defendants accused of an ERISA fiduciary breach is inconsistent, there are some favorable trends in the case law – such as the willingness of some courts to require that plaintiffs plead specific facts demonstrating that the officers and directors named as defendants are first, ERISA fiduciaries, and second, involved with the challenged activities.

The ability to dismiss directors at the earliest stages by showing that neither is the case is of considerable value and importance.

Clever plaintiffs’ attorneys, with the help of the courts, have set a trap for the unwary. With a bit of preventative maintenance, you should be able to protect senior management from these lawsuits.

Review your company’s benefit plans, board resolutions and delegations to see who is likely to be targeted as a fiduciary. Then carefully determine whether a structural reconfiguration is desired and practical.

If possible, push responsibility for plan amendments, investment selection and plan administration down as far as possible. Keeping your retirement plans out of the board room and the executive suite will go a long way to protecting senior executives.

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