

Morgan Lewis

C O U N S E L O R S A T L A W



LABOR AND EMPLOYMENT LAW SEMINAR

**Protecting Executives and Directors from
ERISA Fiduciary Liability:
Best Practices for Risk Avoidance**

Charles C. Jackson and Brian T. Ortelere

October 27, 2005

Today's Topics



- I. Statutory framework**
- II. The current litigation climate**
- III. Appointing fiduciaries and monitoring their performance**
- IV. Practical suggestions to reduce litigation risk**
- V. Communications with plan participants**

I. STATUTORY FRAMEWORK

- **Who is a fiduciary?**
 - **Expanding the definition and reach will sweep more individuals into litigation**
- **What are a fiduciary's duties?**

WHO IS A FIDUCIARY?

- **Functional test – a person is a fiduciary *to the extent* he or she:**
 - **Exercises discretionary control over plan management**
 - **Exercises any authority or control over plan assets**
 - **Has any discretionary authority over plan administration**
 - **Gives investment advice for a fee**

WHO IS A FIDUCIARY?

- **A person becomes a fiduciary by:**
 - Being formally designated as a fiduciary
 - Functioning as a de facto fiduciary
 - Appointing other fiduciaries
- **Default rule -- the plan sponsor (usually the employer) is deemed to be the plan administrator if one is not named in the plan document**

WHAT ARE A FIDUCIARY'S DUTIES?

- The exclusive purpose rule (duty of loyalty)
- The prudent person standard (duty of care)
- Diversification
- Following the terms of the plan
- Damages against breaching fiduciaries for plan's losses are joint and several, and per se
 - Huge pressure to settle early if damages are large

II. THE CURRENT LITIGATION CLIMATE

- **Best exemplified by “stock drop” cases**
 - *Enron, WorldCom, Global Crossing, Marsh & McLennan* -- alleged fraud or accounting irregularities contributed to cataclysmic failure of plan sponsor
 - Cases where stock value abruptly dropped (“*Enron-lite*”)
- **Settlements are substantial**
 - *Enron*: \$85 M (outside directors only)
 - *WorldCom*: \$47.1 M
 - *Global Crossing*: \$78 M

II. THE CURRENT LITIGATION CLIMATE

- **Plaintiffs' basic theories**
 - **Fiduciaries had inside information re financial problems that they failed to disclose to plan participants**
 - **Offering company stock to investment fund was imprudent**
 - **The company and/or board did not adequately monitor the operational fiduciaries**
- **These basic theories are popping up in many types of fiduciary litigation, not just in stock-drop cases**
- **Defendants typically include the company, the named fiduciaries, and some officers and directors**

III. APPOINTING FIDUCIARIES AND MONITORING THEIR PERFORMANCE

- **Fiduciaries responsible for retirement plan operational decisions, such as deciding claims, interpreting and applying the plan, and selecting investment options and investment managers, are typically appointed by the board of directors, a board committee, or a company officer or executive**

III. APPOINTING FIDUCIARIES AND MONITORING THEIR PERFORMANCE

- Under ERISA, whoever appoints a fiduciary also has limited fiduciary duties:
 - To be prudent in deciding whom to appoint
 - More importantly, to monitor the performance of the appointed fiduciary
- The scope of these limited duties is not yet fully developed in the case law

III. APPOINTING FIDUCIARIES AND MONITORING THEIR PERFORMANCE

- In many lawsuits, attorneys representing groups of employees and retirees are trying to use the duty to monitor as a basis for holding directors, officers, and other executives responsible for the investment decisions of appointed fiduciaries
- The Department of Labor has supported some of these lawsuits (e.g., *Enron*)

III. APPOINTING FIDUCIARIES AND MONITORING THEIR PERFORMANCE

- **Why have plaintiffs' attorneys pursued this strategy?**
 - More deep pockets -- personal liability
 - Additional insurance coverage
 - Broaden the scope of discovery
 - Make settlement more likely
- **Case law in this area is unsettled -- “bad facts make bad law” (e.g., *Enron*)**

IV. PRACTICAL SUGGESTIONS TO REDUCE LITIGATION RISK

If your ERISA plan invests in company stock:

- Consider appointing an investment committee composed of non-officers and non-board members
- Retain an independent advisor to assess whether company stock continues to be appropriate; consider appointment of independent fiduciary
- Remind employees about advantages of diversification and risks of overconcentration in company stock
- Consider easing restrictions on ability to sell company stock
- Evaluate whether, after *Schering Plough*, the plan design is optimal, i.e., whether stock should be held in an ESOP

IV. PRACTICAL SUGGESTIONS TO REDUCE LITIGATION RISK

Suggestions applicable to all ERISA fiduciaries

- Meet regularly, keep minutes, and read plan documents (e.g., SPD)
- Document all decisions -- demonstrate prudent process
- Develop and follow written investment policy
- Confirm compliance with investment policy

“Procedural prudence” is paramount, particularly to the Department of Labor.

IV. PRACTICAL SUGGESTIONS TO REDUCE LITIGATION RISK

- **Implement formal investment-education program**
- **Allow participants to change investments daily**
- **Review ERISA fiduciary insurance policies and amounts of coverage**
- **Consider obtaining or increasing fiduciary liability insurance coverage**
- **Consider compliance audit**

IV. PRACTICAL SUGGESTIONS TO REDUCE LITIGATION RISK

Suggestions applicable to appointing fiduciaries

- Carefully evaluate fiduciary candidates and document selection process
- Ensure that candidates' qualifications are consistent with duties
- Provide training to fiduciary candidates

IV. PRACTICAL SUGGESTIONS TO REDUCE LITIGATION RISK

- **Meet regularly with appointed fiduciaries to review their reports**
 - **Performance**
 - **Fees and costs**
 - **Significant events**
- **Document monitoring of appointed fiduciaries**
- **Replace nonperforming fiduciaries**

V. COMMUNICATING WITH PLAN PARTICIPANTS



- **The fiduciary duty of disclosure**
 - Duty to satisfy written disclosure obligations set forth in ERISA
 - Duty not to lie when asked
 - Duty to affirmatively disclose material information, even when not asked

V. COMMUNICATING WITH PLAN PARTICIPANTS

- **Circumstances where risk of violation of duty of disclosure is higher than usual**
 - **Involuntary termination of employment**
 - **Benefit elections**
 - **“Serious consideration” of plan amendments**
 - **“Informal” benefit communications**
 - Beware the “water cooler” or “grapevine” fiduciary

V. COMMUNICATING WITH PLAN PARTICIPANTS

Regarding Written Communications

- Include appropriate discretionary language in plan document/SPD
- Use plain language in written communications
- Include a “reservation of rights” clause in written communications

V. COMMUNICATING WITH PLAN PARTICIPANTS



- **Maintain historical records of written communications**
- **Have fiduciaries and benefits staff review written communications for accuracy and consistency**
- **Train those responsible for benefit communications**

V. COMMUNICATING WITH PLAN PARTICIPANTS

Regarding Oral Communications

- Develop a script for oral benefit communications
- Limit who has authority to communicate about benefit issues
- Maintain a log of benefit-related inquiries and requests for plan documents (e.g., SPDs)
- Document communications with claimants and their counsel

V. COMMUNICATING WITH PLAN PARTICIPANTS

- **Act timely on requests, claims, and appeals**
- **Be mindful: Communications with company's in-house counsel on fiduciary issues may not be privileged**

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