

esop and employee benefits lawflash

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Court Upholds Validity of ERISA Fiduciary Indemnification

Ruling rejects DOL challenge of an agreement by a 100% ESOP-owned company to advance defense costs and indemnify a trustee.

On March 15, the U.S. District Court for the Central District of California issued an order in *Harris v. GreatBanc Trust Co.* dismissing, without leave to amend, a claim brought by the U.S. Department of Labor (DOL) to invalidate a defense and indemnification agreement between an ESOP trustee and the company sponsor of the ESOP.¹ The DOL's position was that the agreement violated section 410(a) of ERISA, which states that "any provision in an agreement or instrument which purports to relieve a fiduciary from responsibility or liability for any responsibility, obligation, or duty under this part shall be void as against public policy." The court rejected this argument and upheld the validity of the agreement. This ruling is very important because if the DOL position had been upheld and ESOP trustees could not be defended or indemnified if a claim were brought against them, then few, if any, professional trust companies or private individuals would be willing to serve as ESOP trustees.

Facts

The DOL sued the ESOP trustee and the plan sponsor company in connection with a transaction under which the ESOP became the 100% owner of the company's stock. The ESOP trustee's engagement agreement with the company contained a defense and indemnification provision. Because the terms were important to the court's decision, the entire provision is set forth below:

For purposes of this Section 14, the term "Indemnitees" shall mean [the ESOP trustee] and its officers, directors, employees, and agents. Subject to the applicable provisions of ERISA, [the plan sponsor company] shall indemnify the Indemnitees for any loss, cost, expense or other damage, including attorney's fees, suffered by any of the Indemnitees resulting from or incurred with respect to any legal proceedings related in any way to the performance of services by any one or more of the Indemnitees pursuant to this Agreement, the Plan or the Trust. The indemnification provided for in this Section 14 shall include, but not be limited to:

(a) any action taken or not taken by any of the Indemnitees at the direction or request of [the plan sponsor company], any agent of [the plan sponsor company], or any committee or fiduciary under the Plan or Trust; and

(b) all costs and expenses incurred by the Indemnitees in enforcing the indemnification provisions of this Section 14, including attorney's fees and costs.

However, these indemnification provisions shall not apply to the extent that any loss, cost, expense, or damage with respect to which any of the Indemnitees shall seek indemnification is held by a court of competent jurisdiction, in a final judgment from which no appeal can be taken, to have resulted either from the gross negligence or willful misconduct of one or more of the Indemnitees or from the violation or breach of any fiduciary duty imposed under ERISA on any

1. *Harris v. GreatBanc Trust Co.*, No. EDCV12-1648-R (DTBx) (C.D. Cal. Mar. 15, 2013), available at http://www.morganlewis.com/documents/GreatBancTrust_MotiontoDismiss.pdf. Morgan Lewis represented defendant GreatBanc Trust Co. in this matter.

one or more of the Indemnitees.

An Indemnitee who receives an advancement of fees or expenses from [the plan sponsor company] pursuant to this paragraph shall make arrangements reasonably satisfactory to [the plan sponsor company] to ensure that such Indemnitee will reimburse [the plan sponsor company] for such advancements in the event it is determined the Indemnitee is not entitled to retain such amounts hereunder.²

The DOL's Position

The DOL argued that an ESOP-owned company's assets are plan assets because the ESOP is a stockholder and every dollar spent by the company reduces the value of the ESOP. To support this argument, the DOL cited *Johnson v. Couturier*,³ a decision that upheld a preliminary injunction prohibiting a 100% ESOP-owned company from advancing defense costs to fiduciaries.

The DOL also challenged the validity of the defense and indemnification provision at issue on two other grounds. First, the DOL took the position that, even though the provision did not provide indemnification for a fiduciary found liable in a final judgment from which no appeal can be taken, the provision could be read to provide indemnification of a breaching fiduciary that settles a claim rather than litigates. The DOL argued that ERISA section 410(a) prohibits agreements that relieve a fiduciary of "liability" and that the term "liability" is not limited to liability imposed by final judgment. According to the DOL, a settlement of a claim where the fiduciary had breached a duty could constitute improper shifting of liability.

Second, the DOL took the position that the provision for advancement of the ESOP trustee's defense costs by the company was invalid under ERISA, notwithstanding that the provision called for the ESOP trustee to make reasonably satisfactory arrangements to reimburse the company in the event that the ESOP trustee was finally adjudged liable for breaching a fiduciary duty, because the trustee ultimately might not have the wherewithal to repay the defense costs.

The Court's Decision

The court recognized that, as a general rule, the "plan-asset rule"⁴ provides that assets of an operating company that sponsors an ESOP or other employee benefit plan are **not** assets of the plan and that, absent facts like those in *Couturier*, there is no legal basis to treat defense and indemnity payments by a 100% ESOP-owned company as if they were payments by the plan itself.

The court ruled that the DOL's reliance upon the holding in *Johnson v. Couturier* was misplaced. The court discussed the following three factors in *Couturier* that were distinguishable from the facts in the *GreatBanc* case:

1. The agreement in *Couturier* did not exclude indemnification for breaches of fiduciary duties under ERISA, whereas the agreement in *GreatBanc* disallowed indemnification if the fiduciary was adjudged liable for breach of fiduciary duty in a final judgment.
2. In *Couturier*, the plaintiffs had moved for a preliminary injunction and had demonstrated, to the trial court's satisfaction, that they met the requisite elements for a preliminary injunction, including that they would likely succeed in proving that the defendants had breached their ERISA fiduciary duties. In *GreatBanc*, there was no showing that the DOL would likely succeed in proving a breach of fiduciary duty by the ESOP trustee.
3. In *Couturier*, the plan sponsor was not an operating company. It had sold substantially all of its assets to another company and had adopted a plan of liquidation pursuant to which the ESOP participants would receive the net cash proceeds of the sale, so that any defense or indemnification payments would reduce the

2. *Id.*, slip op. at 3–4.

3. *Johnson v. Couturier*, 572 F.3d 1067 (9th Cir. 2009).

4. 29 C.F.R. §§ 2510-3.101(a)(2), 3.101(h)(3).

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benefits payable to the ESOP participants on a dollar-for-dollar basis. In *GreatBanc*, the plan sponsor was an operating company.⁵

The *GreatBanc* court thus concluded that the *Couturier* case involved “rather unique circumstances” and rejected the DOL’s attempt to expand the application of the *Couturier* decision.⁶

The court in the *GreatBanc* case also rejected the DOL’s argument that the indemnification provision would allow settling fiduciaries to escape liability, observing that the DOL had cited no legal authority that supports extending the reach of ERISA section 410(a) to preclude advancement of defense costs incurred by a fiduciary in defending an action alleging fiduciary breach because of the mere possibility that the parties may settle the case rather than obtain an adjudication on the merits.⁷ The court noted that the DOL was the plaintiff in the action and could always refuse to settle or could impose any conditions on settlement that it saw fit.

The court also rejected the DOL’s request to invalidate the provision for advancement of attorneys fees and expenses to defend the trustee on the (hypothetical) ground that the trustee might not be able to repay them if a court ultimately determined that the trustee had breached its duties under ERISA. The court stated that if the DOL was concerned about the trustee’s ability to reimburse defense costs, the DOL could seek a bond, but setting aside the agreement was not necessary or appropriate.

Implications

The court’s ruling in *GreatBanc* affords protection for ERISA fiduciaries by upholding their right to have their attorneys fees and expenses to defend claims against them paid by the plan sponsor and to be indemnified by the plan sponsor in a settlement of claims, except where a fiduciary has been finally adjudged to have committed a breach of fiduciary duty under ERISA.

Contacts

If you have any questions or would like more information on the issues discussed in this LawFlash, please contact any of the following Morgan Lewis attorneys:

Chicago

David Ackerman	312.324.1170	dackerman@morganlewis.com
Deborah S. Davidson	312.324.1159	ddavidson@morganlewis.com
Brian D. Hector	312.324.1160	bhector@morganlewis.com
Elizabeth S. Perdue	312.324.1180	eperdue@morganlewis.com
Louis L. Joseph	312.324.1726	louis.joseph@morganlewis.com

Dallas

John A. Kober	214.466.4105	jkober@morganlewis.com
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Los Angeles

Scott E. Adamson	213.612.7365	sadamson@morganlewis.com
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Philadelphia

Paul A. Gordon	215.963.5568	pgordon@morganlewis.com
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San Francisco

Nicole A. Diller	415.442.1312	ndiller@morganlewis.com
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5. *GreatBanc*, slip op. at 6.

6. *Id.*

7. *Id.* at 7.

Morgan Lewis

Washington, D.C.

Daniel L. Hogans

202.739.5510

dhogans@morganlewis.com

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