

Market Collapse Places Fiduciaries at Risk but With Resources

Kerri J. Atencio

Leave every hope, ye that enter.

(Sign over the river creating the border with the underworld in Dante's *Inferno*.)

Beware all who would enter here: the land of the retirement plan fiduciary is not for the weak or faint of heart, or those with a queasy stomach. And in These Tough Economic Times, the thankless job can be downright frightening. A maze of new pitfalls, snares, and hazards now lie before the fiduciary of These Tough Economic Times, and even the most seasoned of them will likely find some of the changes difficult to implement by their rapidly approaching deadlines. Not convinced? Sounds overly dramatic? A quick check of the Appendix at the end of this article should convince you otherwise.

Quite simply, a failing economy means that retirement plans take a hit. Responsible, hard-working employees faced with unprecedented losses in their savings will start looking for places to lay the blame (and, in some cases, not undeservedly so). A failing econ-

omy also inevitably means that the country's lawmakers will jump into action and create new rules and regulations to try to correct the problems.

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Both are happening here and now. Witness the largest spending bill the federal government has ever enacted: the American Recovery and Reinvestment Act of 2009. Those who have not met their obligations under the rules and regulations of new and old are finding themselves the targets of fiduciary duty litigation. A fiduciary may be found to be *personally* liable for his or her official acts on behalf of a plan. Indeed, a fiduciary may be responsible for another fiduciary's breach in some situations.

Employers in the utilities sector are not immune from the damaging effects of the economy on their retirement plans. Therefore, this article is designed to provide a survey of fiduciary exposure issues in two parts. The first will explore recent trends in fiduciary litigation, and the second will look at some of the pertinent changes in the law and how employers are coping with them.

ERISA IS THE SOURCE OF PLANS AND FIDUCIARIES

One cannot discuss the litigation surrounding fiduciaries without a basic understanding of the Employee Retirement Income Security Act of 1974¹ (ERISA). Generally speak-

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ing, ERISA is a federal law that establishes minimum standards for most voluntarily established pension (and health, life, and disability) plans in the private sector.² ERISA is thus the source of the standards of conduct for those responsible for the management of employee benefit plans (fiduciaries) and defines who those fiduciaries are. A fiduciary is someone who has discretionary authority or exercises control over the management of the plan or the management and disposition of plan assets, or gives investment advice to the plan, or who has discretionary responsibility for plan administration.³

Those persons or entities cloaked with fiduciary status have the responsibility to discharge their duties in the sole interest of the participants and beneficiaries of the plan, with the objective of providing benefits and defraying plan expenses.⁴ Fiduciaries are judged under a *prudent man* standard.⁵ Many times, this means that fiduciaries—at least those in charge of determining investments and investment options—have a duty to diversify a plan's assets.⁶ ERISA imposes other, more specific duties on fiduciaries, including the avoidance of self-dealing and conflicts of interest.⁷

This backdrop for recent case law shows a continuing trend in pension-plan litigation involving suits over the amount of fees charged to a plan and suits alleging breach of fiduciary duties when the value of an employer's stock heads south. Expect to see this trend continue and likely intensify as a result of the bad economy.

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STOCK-DROP CASES

We start with “stock-drop” cases. Even though a fiduciary is judged on a prudent-man standard and not on the performance of the stock (i.e., fiduciaries are not liable based on 20/20 hindsight), it is the declining value that motivates participants to head to their

local plaintiff's lawyer. Stock-drop cases typically involve one or more of three general allegations: that the fiduciary should not have allowed the employer's stock to be offered as an investment option in the plan; that the fiduciary should not have allowed the employer's stock to remain an investment option; and/or that the fiduciary failed to provide adequate disclosures about the value of the employer's stock. Some fiduciaries cannot win, however, and have been faced with the allegation that the sale of the company stock was a breach of duty.⁸ Thankfully, the First Circuit and *W.R. Grace* got it right, providing a model for employers to follow.

In what is likely to become a familiar scenario for many companies in the days to come, *W.R. Grace* filed for bankruptcy. In the midst of doing so, *W.R. Grace* determined that its Investment Benefits Committee (made up of *W.R. Grace* officers) responsible for making investment decisions for the retirement plan and for offering investment options to plan members might have a conflict of interest in deciding whether to maintain the company's stock in its portfolio. To address the conflict, the committee retained the services of State Street Bank to evaluate whether it was prudent to maintain or sell the stock. State Street conducted a thorough analysis of market conditions, the bankruptcy and reorganization plan, and the ongoing asbestos litigation in which the company was a defendant and concluded that the stock might soon become worthless—hence, that it should be sold. The stock was in fact sold, and participants in the plan then filed suit, claiming that the price was artificially low and therefore an imprudent act.

The First Circuit held that the actions of the fiduciaries unquestionably met the prudent-man standard of ERISA. When faced with the conflict of interest, the benefits committee took action to have the plan amended to allow it to appoint State Street to act as a third-party, independent investment manager to determine the propriety of maintaining the company stock. State Street itself retained the services of additional third parties: one to evaluate the financial status of the company and a law firm to provide legal

advice. State Street considered not only the financial analyst's 88-page report, but also the current stock price, the plan, the bankruptcy, the financial outlook of the company, and the potential asbestos litigation exposure in reaching its recommendation to liquidate. The court noted that the performance of the investment in question is not the measure of a fiduciary's conduct, and nor is the prudent man standard a reflection of one factor over others (such as market price), but rather a consideration of the totality of the circumstances. Thus, the fiduciaries met their ERISA obligations as a matter of law.

The fiduciaries of Bausch & Lomb's 401(k) plan scored a recent victory as well by succeeding in dismissing the putative class members' stock-drop claim based on the failure to remove the investment option in B&L stock.⁹ The 401(k) plan was an eligible individual account plan (EIAP) that allowed individual participants to invest in one of several funds, including the B&L Stock Fund. The plaintiff participants sued, alleging breach of the fiduciaries' duties upon the discovery that fraud by certain employees had led to the misstatement of revenues and, thus, the artificial inflation of stock prices.

The plaintiffs could only prove that the fiduciaries abused their discretion in allowing the stock if B&L were shown to be in a state of crisis or its viability as a company was in jeopardy. The plaintiffs did not do this.

The fiduciaries should not have allowed participants in the EIAP to direct their contributions into the Stock Fund, they said. The court held that the plaintiffs' allegations in their complaint could not overcome the so-called Moench presumption that says decisions by fiduciaries of employee stock ownership plans (ESOPs) to allow investment in company stock are a presumptively prudent act.¹⁰ While the fiduciaries were not absolved of their ERISA duties to exercise care with regard to plan investments, the plaintiffs could only prove that the fiduciaries abused their discretion in allowing the stock if B&L were

shown to be in a state of crisis or its viability as a company was in jeopardy. The plaintiffs did not do this, and the claim was properly dismissed.

The plaintiffs' claim for breach of ERISA fiduciary duties for failure to provide material information about the company and providing false information about the value of the stock was also dismissed in that case. The Securities and Exchange Commission filings containing the allegedly false information were not made under any ERISA-imposed duties, and any disclosure of nonpublic adverse information about the company to participants would have constituted illegal insider trading.

Not surprisingly, the Ninth Circuit has not been as generous toward defending fiduciaries.

In *In re Syncor ERISA Litigation*,¹¹ the participants in the Syncor ESOP sued the company, the committee who administered the plan, and others for violations of ERISA. These class-action plaintiffs alleged that the defendants breached their fiduciary duties when they allowed the plan to continue to acquire and hold Syncor stock in the ESOP when they knew that a scheme to bribe doctors in Taiwan and China to use the products was artificially inflating sales numbers and, thus, the price of the stock. When the bribes were discovered and made public, the stock price lost half its value and resulted in a loss of up to \$65 million to the plan.

The Ninth Circuit said that it would not adopt and apply the Moench presumption of prudence as a defense to the claim that the failure to diversify the ESOP was a breach of the defendants' duties. Nor was the rule about rebutting such a presumption (i.e., that a plaintiff was required to show that the company was in serious decline or that self-dealing was involved) an appropriate application of the prudent-man standard of whether the fiduciaries' purchase and holding of the Syncor stock was a prudent investment. Financial viability is one factor to consider, but a violation could occur in circumstances like those at bar in which the discovery of a bribery scheme of which the fiduciaries were or should have been aware led to an instantaneous drop in stock price.

These are only a few examples of the types of issues being raised in stock-drop litigation. As a general matter, however, the case law instructs that employer-related fiduciaries must be extremely thorough and cautious in the exercise of their duties, especially when deciding to purchase or sell company stock (whether held in an ESOP or a traditional 401(k) plan). When the employer starts heading for financial trouble, investment fiduciaries (typically officers, directors, and/or employees of the company making up a benefits committee) must be on their toes so that they can identify potential conflicts of interest resulting from the fact that loyalty to the employer in the form of continuing to purchase or hold corporate stock may conflict with their obligations to act solely in the interest of plan participants and beneficiaries.

When the employer starts heading for financial trouble, investment fiduciaries must be on their toes.

Retaining a reputable, experienced third party to complete an investigation of all factors affecting stock-related transactions will go a long way toward satisfying the investment fiduciaries' ERISA obligations.

CASES ABOUT ADVISORY FEES

The Seventh Circuit appears to be the first federal appellate court to issue a decision on a fee disclosure case. *Hecker v. Deere & Co.*¹² serves as a good example of what an employer in the utilities industry might expect to see from disgruntled plan participants in the fee arena.

Deere sponsored two self-directed 401(k) plans for its employees and hired Fidelity Trust to act as trustee. Fidelity Trust managed two investment funds offered to the plan participants, and Fidelity Research, a related company, acted as the advisor to the 23 Fidelity mutual fund options. Fidelity Research charged the plans a fee based on the volume of assets placed with a particular fund, and then shared those fees with Fidelity Trust. Fidelity Trust considered the share

of the fees it received to be the charge for its trustee services on behalf of the plan, rather than charging Deere directly.

This revenue-sharing information was not necessarily known by Deere and certainly not disclosed to the plan. The plan participants were upset by the high fees and sued, alleging breaches of fiduciary duties by Deere and the Fidelity entities. The fees and expenses were unreasonable and excessive according to the plaintiffs, and the revenue-sharing arrangement was an improper charge for administration of the plans.

On appeal from the district court, which ruled in favor of all defendants on their motions to dismiss the complaint, the Seventh Circuit quickly disposed of the claims against the Fidelity entities. They did not exercise control over the investment options (even though per the agreement with Deere, Fidelity vehicles were the only ones offered to participants), and the fees Fidelity Research collected were not "plan assets."

The claims against Deere were properly dismissed too, said the court, in the first instance because nothing in ERISA required the company to disclose the fee arrangement. While it was not necessarily a good thing for Deere to give plan members the impression that the company was actually paying the fees on their behalf, there was no evidence that this was an intentional misstatement and the amount of the fees assessed had been accurately disclosed. Nor was such specific information material because it would be the overall cost of a fund, and not what the fund manager did with the money afterward that would affect an investor's decision.

Finally, Deere had not breached its fiduciary obligations by selecting the investment options that were offered through the plans. Several options were available, with fees ranging from .07 percent to 1 percent of the fund assets, these options and their corresponding fees were available in the open marketplace, and Deere was not required to find and select the investment options with the lowest fees, nor offer any particular mix of options from different managers. And in any event, the "safe harbor" fiduciary defense under Section 404(c) would apply because these were

participant-directed plans, the plans offered more than 2,500 investment options, and the required pieces of information about the investment alternatives were provided.

PROGNOSIS FOR A CONTINUED HEAVY DOSE

Stock-drop and fee-disclosure cases are likely to continue to be a vehicle of choice for employees angry about the losses of their retirement savings.

The current market conditions inevitably mean that companies' stocks will lose value, which in turn leads to increasing losses in more and more retirement plans.

New cases are probably being filed as I write this.¹³ Why? First of all, the current market conditions inevitably mean that companies' stocks will lose value, which in turn leads to increasing losses in more and more retirement plans. More importantly, these cases will continue to rise because they are susceptible to being converted to class actions, which means that they are even more expensive to litigate and thus end up settling for substantial sums. Even if individual members of the class recover a small amount of the total settlement pie, the suits remain profitable for the plaintiffs' lawyers who are allowed to recover their own portion for their fees. Indeed, with firms devoted to searching out such suits, this is the perfect climate for this kind of litigation to flourish.¹⁴

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AFFIRMATIVE ACTION BY EMPLOYERS?

Like many employers of late, utility companies may be struggling to survive while at the same time wanting to protect their employees.

Thus, what is a utility company with knowledge of substantial plan losses and its

own share of ire to do? No longer is the only option to sit back and hope that your employees are eminently reasonable, loyal, and allergic to courtrooms.

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Go After Other Fiduciaries

Fiduciary-on-fiduciary litigation is starting to take a place on the main litigation stage, with plan committees seizing the reins to go after investment advisors and managers whose negligence or fraudulent actions are blamed for monumental drops in plan values.¹⁵ While this proactive litigation strategy would not be implemented in stock-drop cases, the strategy has the potential to be a useful tool to recoup other losses. Careful consideration must be given after consultation with experts in defending ERISA fiduciary cases before starting down this road, however, as the plan fiduciary may be forced to simultaneously *defend* against similar claims by plan participants who are allowed to intervene. The possibility of counterclaims for cofiduciary liability exists as well.

Suspend Company Matching

One thing that utilities may be considering is the prospect of suspending the company matches. Suspending a matching contribution can save a considerable amount of money without having to institute layoffs or pay cuts, and can be relatively easy depending on the type of plan in question.

If the plan has a discretionary match provision, the employer contributes as much or as little as it wants when it wants to. In those cases, a suspension is relatively painless. On the other hand, if the plan is a "safe harbor" plan, the sponsor (i.e., the employer) is exempt from IRS nondiscrimination testing that is designed to prevent higher-ups from contributing significantly more to the plan than lesser-paid employees.

Suspending a match for those types of plans also removes the testing exemption, meaning

that the company's executives and other managers will not be able to save as much money as they were used to. Any suspension must be crafted with care to ensure that the intent is accomplished and that "anti-cutback" rules under the law are not violated.

Remove Groups From Plan

More drastic measures of removing an employee group from the plan may also be considered. Layoffs may nevertheless be necessary, and when either of these things happen, the utility must be aware of the partial termination rule.

When a partial termination of a retirement plan occurs is not a bright-line test, but rather depends on the totality of the facts and circumstances. If a partial termination occurs, the plan must 100 percent vest the accounts of all affected participants. In essence, the plan is treated as terminated with respect to those participants. A partial termination also requires an allocation of any unallocated accounts (e.g., forfeitures) that the plan may be holding.

Often, an employer does not realize that a partial termination has occurred until after many participants have already received distribution of their plan benefits. Once participants receive distributions, it can be difficult to locate the participants because they no longer keep plans up to date on their current addresses. Also, questions arise about the administration of the cash-out and other distribution and consent rules, and possible misuse or misallocation of amounts that should not have been forfeited. These reasons underscore the importance of making a timely determination of whether a partial termination has occurred.

In terms of what else utilities can be doing to protect themselves, they need to stay on top of the changes in the law to ensure that they are complying with new requirements affecting benefit plans. The Appendix provides an overview of the changes brought about by the Worker, Retiree, and Employer Recovery Act of 2008 and recommendations for dealing with them. Expect to see new regulations and initiatives regarding fee disclosures to plans and participants in the coming year as well.

Guidance from the Department of Labor to fiduciary victims of the Bernie Madoff scandal is available and should be reviewed whenever a plan is facing similar losses.¹⁶

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CONCLUSION

These Tough Economic Times too shall pass, but not likely anytime soon. While we wait it out, energy-sector employers and their employees who administer and manage their benefit plans must take precautions to protect against breaches of their ERISA duties—not just for their own sake, but also for the well-being of the plans and the participants in them. ○

NOTES

1. 29 U.S.C. § 1001, *et seq.*
2. See <http://www.dol.gov/dol/topic/health-plans/erisa.htm>.
3. 29 U.S.C. § 1002(21)(A).
4. 29 U.S.C. § 1104(a)(1).
5. *Id.*
6. 29 U.S.C. § 1104(a)(1)(C).
7. 29 U.S.C. §§ 1106, 1107.
8. *Bunch v. W.R. Grace & Co.*, 2009 WL 211054 (1st Cir. 2009).
9. *In re Bausch & Lomb, Inc. ERISA Litigation*, 2008 WL 5234281 (WDNY Dec. 12, 2008).
10. An EIAP is a form of an ESOP.
11. 516 F.3d 1095 (2008).
12. 07-3605 & 08-1224 (7th Cir. Feb. 12, 2009).
13. Companies in the financial sector have been a particular target, with two new stock-drop suits being filed against Hartford Financial Services, as well as cases in late 2008 against Bear Stearns, Fannie Mae, Freddie Mac, Lehman Brothers, and Wachovia, to name a few.
14. See <http://www.erisafraud.com/Default.aspx?tabid=1038>.
15. See *BP Corp. North America, Inc. Savings Plan Investment Oversight Committee v. Northern Trust Investments, N.A.*, N.D.Ill., No. 1:08-cv-06029; *FedEx Corp. v. Northern Trust Co.*, W.D.Tenn., No. 2:08-cv-00827; *Board of Trustees of the AFTRA Retirement Fund v. JP-Morgan Chase*, S.D.N.Y. No. 1:09-cv-00686 (filed Jan. 23, 2009); *Pension Fund for Hospital and Health Care Employees-Philadelphia and Vicinity v. Austin Capital Mgmt. Ltd.*, E.D.Pa. No. 2:09-cv-00615 (filed Feb. 12, 2009).
16. See <http://www.dol.gov/ebsa/pdf/madoffguidance.pdf>.

Appendix. Recent Changes in the Law Affecting Retirement Plans Through the Worker, Retiree, and Employer Recovery Act of 2008

Defined-Contribution Plans

Requirement	Change	Recommendation
Required Minimum Distributions (RMDs)	Generally, participants are required to begin taking minimum distributions (RMDs) by April 1 of the year after reaching age 70½, and continue every year thereafter. In addition, RMDs to beneficiaries generally must begin by the end of the calendar year following the year of the participant's death and continue until the benefit is fully distributed by the fifth calendar year following the year during which the participant died. The Act provides a one-year suspension of these RMD requirements. Specifically, for 2009 only, defined-contribution plans, governmental 457(b) plans and individual retirement plans are not required to make RMDs. Distributions that would otherwise be RMDs in 2009 are eligible to be rolled over. However, the Act provides that the direct rollover notice and the 20 percent income tax withholding requirement are not required to apply to such distributions. RMDs for 2008 were not suspended, so if a participant first turned 70½ in 2008 and is owed her first RMD for 2008 by April 1, 2009, the RMD is still due.	Plan sponsors should review their plans to determine if an amendment is needed to address this change. Amendments must be adopted on or before the last day of the plan year beginning on or after January 1, 2011. For a calendar-year plan, the plan must be amended on or before December 31, 2011. Plan sponsors may want to review and possibly revise distribution notices.
Rollovers to Roth IRAs	Effective for distributions made after December 31, 2007, the Act provides that the income limits do not apply to rollovers from a designated Roth account in a 401(k) or 403(b) plan to a Roth IRA.	Distribution notices should be updated.
Gap Period Income	Effective for plan years beginning after December 31, 2007, the distribution of excess elective deferrals are only required to include the income allocable to such excess through the end of the year for which the deferral was made, not through the distribution date as provided in regulations.	Plan sponsors should review their plans to determine if an amendment is needed to address this change. Amendments must be adopted on or before the last day of the 2009 plan year.
Eligible Automatic Contribution Arrangements (EACAs)	The Act repealed the requirement that an eligible automatic contribution arrangement (EACA) invest default contributions in a qualified default investment arrangement (QDIA) in accordance with the regulations enacted by the Department of Labor. Even though an EACA is not required to invest default contributions in a QDIA, plan sponsors may want the default investment to be a QDIA for other reasons.	Plan sponsors with EACAs should consider whether they wish to change the default investment to an investment that is not a QDIA, and if a change is desired, they must review their plans to determine if an amendment is needed to address this change. Amendments must be adopted on or before the last day of the 2009 plan year if retroactive application to the first day of the plan year is desired.

Appendix. Recent Changes in the Law Affecting Retirement Plans Through the Worker, Retiree, and Employer Recovery Act of 2008 (*continued*)

Defined-Benefit Plans

Requirement	Change	Recommendation
Funding Shortfalls in Plans	<p>The Act provides that single-employer pension plans that fall below the set target funding percentage for a particular year (92 percent for 2008; 94 percent for 2009; 96 percent for 2010) will only be required to fund up to the specified funding percentage for that year instead of 100 percent. For example, if a plan was funded at 91 percent for 2008, the funding shortfall for 2008 would be 1 percent, and the plan would need to fund to 94 percent in 2009, rather than 100 percent.</p>	<p>Discuss with the plan's actuary.</p>
At-Risk Plans	<p>Under the Act, single-employer defined benefit plans that are less than 60 percent funded may look back to the previous plan year to determine their funding status for purposes of the benefit accrual limit only. This only applies for plan years beginning on or after October 1, 2008, and before October 1, 2009.</p>	<p>Discuss with the plan's actuary.</p>
Lump-Sum Distributions	<p>For defined-benefit plans maintained by employers with no more than 100 employees, the Act modifies the interest-rate rules for adjusting a participant's benefit to a straight life annuity effective for years beginning after December 31, 2008. Under the Act, the interest rate must be the greater of 5.5 percent or the interest rate specified in the plan.</p>	<p>Plan sponsors should review their plans to determine if an amendment is needed to address this change. Amendments must be adopted on or before the last day of the 2009 plan year.</p>
Nonspouse Rollovers	<p>Effective for plan years beginning after December 31, 2009, plans <i>must</i> allow nonspouse beneficiary rollovers.</p>	<p>Plan sponsors should review their plans to determine if an amendment is needed to address this change. Amendments must be adopted on or before the last day of the 2009 plan year. In addition, distribution notices should be updated.</p>