



The Perils of Holding Company Stock in Sponsored Plans

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For the Chubb Group of Insurance Companies



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FOREWORD

The growth in fiduciary liability securities claims has had a significant effect on companies both directly (as targets of litigation) and as insurance buyers faced with stricter coverage terms and higher pricing. Therefore, Chubb engaged the law firm of O'Melveny & Myers to write this paper to help our customers and brokers understand the breadth of the problem and to consider ways to reduce their exposure. In this paper, authors Bob Eccles and Dave Gordon deliver a broad overview of recent employer stock litigation, fiduciary duties with regard to company stock, and one's status as a fiduciary and co-fiduciary. They also offer important suggestions for mitigating fiduciary liability, including a checklist of best practices.

At Chubb, we believe that loss prevention continues to gain importance as a means to prevent potentially devastating liability lawsuits from ever occurring. We hope that you find this paper to be useful in your own company's efforts to mitigate its fiduciary liability exposures with regard to securities management.

INTRODUCTION

Recent years have seen a new wave of litigation involving 401(k) and other retirement plans that have invested heavily in the stock of their sponsoring company. The typical case involves a company that has experienced adverse financial events that lead to a significant decline in the company's stock price and sometimes to bankruptcy. Dozens of lawsuits have been filed involving such plans, and although the pace of new filings will likely slow, it would be wishful thinking to assume that new cases will not continue to be filed.

In some senses, these types of cases are not new. All revolve around allegations that plan fiduciaries have breached duties under the Employee Retirement Income Security Act of 1974 (ERISA). Plaintiffs in these cases cite legal principles developed in the nearly 30 years of litigation under ERISA which, in turn, frequently draw on older principles from trust law. Although many of these principles have never been applied in the employer stock context, there is a long history of litigation involving plans, such as employee stock ownership plans (ESOPs), that invest primarily in stock issued by the company that employs plan participants and sponsors the plan.

This wave of litigation, however, is different from its predecessors in two important ways. First, the traditional ESOP cases typically involved a specific transaction in which employer stock was purchased or sold, and the principal question to be litigated was whether the transaction price was fair to the plan. In contrast, the newer cases challenge a plan's practice, usually over an extended period of time, of buying and holding employer stock, and they effectively attack the prudence or suitability of that stock as a plan investment. Second, the newer cases are being filed more systematically by groups of plaintiffs' lawyers, and this type of litigation is becoming typical whenever a stock's price experiences a sudden and significant decline. Indeed, these ERISA cases are frequently filed at the same time as securities lawsuits and resemble them in many, but not all, respects.

Because we think these cases are here to stay, we thought it useful to try to summarize their main features and to outline some ways in which plan sponsors could act to mitigate their exposure to liability if they become a target of this type of litigation. The only sure way in which plan sponsors can avoid liability relating to plan investments in employer stock is to avoid such investments entirely. Many employers, however, have found employer stock to be a beneficial feature of their plans and have taken advantage of the numerous ways in which ERISA and the tax laws encourage plan investment in employer stock. Thus, this article assumes that the plan sponsor has already made the decision to continue to offer employer stock as an investment option for participants or as a vehicle for matching contributions in 401(k) or other types of defined contribution or individual account plans.

Due to the large number of these cases filed recently, it will be years before the courts resolve fully the legal issues these cases present. Even then, it is likely that different courts will reach different results, in part because the facts of each case are different. Accordingly, the discussion here should be read, not as a prediction of what the courts will ultimately conclude proper fiduciary conduct to be, but as a guide to the issues that have arisen thus far in the cases and ways in which these issues could be addressed to reduce liability exposure.

I. OVERVIEW OF RECENT EMPLOYER STOCK LITIGATION

Although the facts and claims of each case are different, a relatively common thread has emerged: The typical plan at issue is a defined contribution or individual account plan that has, among its investment options, an employer stock fund that consists almost entirely of employer stock, except for some small portion of cash investments for liquidity purposes. The employer suffers some financial trouble, and the stock price drops.

A number of possible factual variations may significantly affect the outcome of a particular case. Sometimes the entire plan or the employer stock fund is labeled an ESOP; in other cases, no such label is applied. Sometimes, particularly in the case of ESOPs, the governing plan or trust document affirmatively requires that employer stock be the exclusive or virtually exclusive investment in the plan or the employer stock fund; in other instances, the language is only permissive or even ambiguous. In some cases, the existence of an employer stock fund is mandated by the governing documents, while, in other cases, its existence is determined by a fiduciary committee, typically composed of senior company employees. In many cases, plan participants decide whether or to what extent their accounts should be invested in employer stock. It is, however, common for the company's matching contributions to be invested in employer stock, and, in some of those cases, the participant cannot change that investment until at least age 55.

In their broadest terms, these cases involve two basic types of claims. First, with the advantage of hindsight, plaintiffs allege that information that was known or knowable by a plan fiduciary should have led to a decision to eliminate or at least minimize plan investment in employer stock. The essence of this claim is the allegation that at some point employer stock became an unsuitable investment for a plan to acquire or hold. Second, plaintiffs allege that fiduciaries made misrepresentations about the stock or failed to make disclosures that they should have known would have changed participants' investment decisions regarding the stock. In many cases, the alleged means of these miscommunications are filings under the federal securities laws or other public statements about company finances that are not limited to an audience of plan participants and beneficiaries.

The breadth and vagueness of these claims is exacerbated by the wide net cast by plaintiffs in attempting to label corporate officials as ERISA plan fiduciaries. Typically, besides the possibility of an independent institutional trustee, a committee of company executives carries out fiduciary functions for the plan; this paper will refer to such a committee as the *named fiduciary committee*. Often, the members of this committee are appointed by a committee of the company's board of directors that is itself given limited fiduciary powers to review and monitor the management and performance of the plan; we'll call this entity the *board committee*. Supported by *amicus curiae* briefs filed by the U.S. Department of Labor (DOL) in some cases, plaintiffs' attorneys argue that all of the members of both of these committees have some limited fiduciary functions that make them liable for losses on the plan's holdings of employer stock, either directly as fiduciaries or indirectly as co-fiduciaries responsible for the breaches of other co-fiduciaries. Plaintiffs have also made allegations of fiduciary status against all directors and senior company executives most likely to know of any nonpublic corporate financial problems, including the chief

executive officer (CEO) and chief financial officer (CFO), even if they are not members of any fiduciary committee.

What plaintiffs seek is to impose personal liability on anyone who can be tagged with fiduciary status to pay to the plan any losses resulting from a breach of duty regarding the employer stock. Since the holdings of company stock in large plans are frequently valued in a range of hundreds of million dollars and sometimes in the billions, the potential for liability exposure in these cases is large. The actual track record in these cases is, however, mixed. Defendants have prevailed in the few cases that have gone to trial, although most of those cases preceded the corporate scandals and stock market decline of the years 2000-2002 that have fueled this recent litigation boom. Defendants have also won a few cases on motions, especially when a court concluded that there was nothing exceptional about a particular company's stock price decline that should have alerted fiduciaries to change course. Of the remaining cases, a few have settled, and most are still pending. In this latter category, plaintiffs have prevailed in several preliminary decisions that have denied part or all of defendants' motions to dismiss.

II. EMPLOYER STOCK AND ERISA'S FIDUCIARY DUTIES

ERISA contains two broad sets of fiduciary duty provisions: the general fiduciary duties set out in Section 404 and the prohibited transaction provisions of Section 406. The claim that a particular employer's stock should not be acquired or held by a plan potentially implicates several of these provisions. The general fiduciary duties are adopted from general trust law and include the familiar trustee duties of undivided loyalty to beneficiaries, prudence (including care, skill, and diligence), and the duty to follow the terms of governing plan and trust documents. The statute also includes an express duty to diversify plan assets, but so-called "eligible individual account plans" (EIAPs) are exempted from that duty. The prohibited transaction provisions are also subject to an exemption that generally allows plans to buy or sell employer stock as long as fair market value is paid or received.

A. The Duty of Loyalty

ERISA codifies the duty of undivided loyalty to beneficiaries in several provisions, including the requirements that a plan fiduciary act "solely in the interest" of the plan and its participants and beneficiaries and "for the exclusive purpose" of serving plan-related goals. In the employer stock cases, plaintiffs generally allege that the fiduciaries had impermissibly divided loyalties because they maintained plan investments in employer stock that served the employer's purposes but hurt the plan.

Courts have struggled with the scope of this duty of loyalty in other contexts. Obviously, if a fiduciary takes action that he or she knows will harm a plan but will advance corporate or personal interests, that is a breach of the duty to act "solely in the interest" of a plan. On the other hand, the mere fact that a fiduciary also has a role as a corporate official does not mean that he or she can never take action for a plan that would benefit the sponsoring company. Rather, the test generally applied is whether an action was intended to benefit a plan regardless of what other or incidental effect it might have on the company.

B. The Duty of Prudence

What the courts refer to as prudence is actually a composite of separate duties of care, skill, prudence, and diligence. In general, the courts compare the conduct of a defendant fiduciary to an objective standard of how a knowledgeable fiduciary would have acted under similar circumstances. Judicial decisions heavily emphasize the diligence component of the standard by examining whether and how the defendant considered issues that would be thought significant by a prudent fiduciary acting in similar circumstances.

C. The Duty of Diversification

As noted above, a specific provision of ERISA, Section 404(a)(2), expressly states that the duty of diversification, and the duty of prudence to the extent it would otherwise require diversification do not apply to EIAPs. An EIAP includes an ESOP, profit-sharing plan, or other form of individual account plan that has an express provision permitting the plan to acquire or hold employer stock in excess of the otherwise applicable limit of 10 percent of plan assets. In other words, an EIAP may, if its terms so provide, hold up to 100 percent (or any lesser amount that is permitted by those terms) of its assets in employer stock without running afoul of any diversification requirement. Without this exemption, heavy concentrations of plan assets in employer stock would present obvious diversification violations.

D. The Duty to Follow Plan Documents

ERISA also generally requires a fiduciary to follow the lawful terms of governing plan and trust documents. The existence of this duty creates potential tension with the duty of prudence that may become evident in the case of employer stock held by a plan. Courts have generally held that the terms of a plan document cannot absolutely eliminate the need to comply with other duties, such as prudence. They have also, however, recognized that a fiduciary of a plan that requires plan investment in employer stock, or mandates the inclusion of an employer stock fund as an option for participants, will have a different set of fiduciary considerations than a fiduciary acting under plan documents that contain no such restrictions.

It is still too early in the development of case law to be able to predict with any certainty what test the courts will develop to resolve this tension. Two federal appellate courts have endorsed a standard under which a fiduciary of a plan requiring employer stock investment will be entitled to a presumption that he or she acted reasonably and prudently in acquiring or holding such stock; two other appellate courts have either applied a similar standard or have suggested that this standard may not be sufficiently protective of fiduciaries. A plaintiff may, however, attempt to rebut this presumption by evidence of the inappropriateness of the stock for plan investment, including evidence showing that the stock suffered a “precipitous decline” or that the fiduciary was aware of the company’s “impending collapse.” These courts have suggested that it may also be relevant to consider the degree to which the fiduciary has a conflict of interest resulting from dual roles acting for the plan and the company and the extent to which the company as settlor of the plan would expect the fiduciary to continue to adhere to the plan document requirements notwithstanding potentially changed circumstances. In some cases, courts have also looked, either as part of the prudence analysis or in an analysis of losses, to what a hypothetical prudent investor would have done regarding the stock, including what other investment managers or investment advisors were doing or saying regarding the stock during the relevant period.

E. Prohibited Transactions

Section 406 contains two separate sets of prohibitions on transactions with parties in interest to a plan and transactions in which a fiduciary engages in self-dealing or acts with conflicts of interest. In general, the statute exempts from these prohibitions transactions involving employer stock that occur for “adequate consideration,” a term that generally means the public trading price of a stock that is traded on a national securities exchange. Since most employer stock transactions involve publicly traded stock that is bought or sold at its public trading price, these prohibitions are generally inapplicable. There are, however, nuances to this analysis, and there are some contrary allegations by plaintiffs in the current wave of cases, so legal advice should be obtained to make sure that no prohibited transactions occur.

III. MISREPRESENTATION AND NONDISCLOSURE CLAIMS

The ERISA case law has dealt with claims of fiduciary misrepresentation and nondisclosure in other contexts, mostly but not exclusively dealing with statements about benefits. What plaintiffs in the employer stock cases are trying to do is to import the farthest-reaching principles from those other cases into the employer stock context.

Although courts have not extensively discussed the source of a fiduciary duty regarding disclosure, a natural source is the duty of undivided loyalty. Affirmative misrepresentations by fiduciaries to participants and beneficiaries would obviously constitute breaches of this duty. In other contexts, the courts have recognized a fiduciary duty in some circumstances to respond fully and truthfully to participant inquiries and even sometimes to volunteer information. It is simply not clear as to the extent, if any, that these same principles will be carried over into the employer stock context.

One dispute regarding these claims is whether particular statements were or were not made in an ERISA fiduciary capacity. Plaintiffs in these cases have frequently relied on general statements made to the public or investors at large, some (but not all) of which were incorporated into materials given to plan participants. Courts have expressed differing views on whether such statements can provide a basis for claims under ERISA as distinct from claims under securities laws. Plaintiffs are likely to urge that ERISA fiduciary duties impose additional disclosure requirements on companies whose stock is held by their retirement plans. Defendants will contend in opposition that Congress did not intend to have ERISA supersede the disclosure scheme already in place under the securities laws or that, at the very least, the ERISA duties should not be extended beyond a prohibition on affirmative misrepresentations and should not trigger a separate set of disclosure duties regarding employer stock.

Unlike the claims attacking the prudence of investing in employer stock, which contend that no one could prudently have decided to invest in the stock, plaintiffs on the misrepresentation claims may be required to show that individual participants relied on particular statements asserted to be misrepresentations in deciding to invest in or hold employer stock. If the courts do impose such a reliance requirement, plaintiffs may also be required to show that the asserted misrepresentations were material in light of other investment information made available to participants. Moreover, defendants who have maintained their plans in conformance with Section 404(c) of ERISA will contend that they are relieved from liability by that provision to the extent participants voluntarily elected to make or maintain investments in employer stock in their plan accounts. Because the question of whether Section 404(c)'s conditions have been satisfied is fact-dependent, this defense has not proven effective at the early motion to dismiss stage of litigation but may grow in importance as the factual record demonstrating the applicability of Section 404(c) is established at later stages of litigation.

IV. FIDUCIARY STATUS AND MONITORING AND CO-FIDUCIARY DUTIES

As discussed earlier, most plaintiffs in these cases have chosen to sweep broadly in determining whom to sue as fiduciaries. Thus, they have chosen to name as defendants not only the company officials that serve in stated fiduciary capacities, but also those officers and directors who appoint the stated fiduciaries and frequently senior executives who may have nonpublic financial information even if they do not hold obvious fiduciary positions. By casting such a wide net, plaintiffs may hope to broaden the possible sources of recovery and also to impute to some defendants, through principles of fiduciary monitoring duties and co-fiduciary liability, knowledge that may be held by other defendants.

Sorting out what defendants should or should not be in the case is a delicate task with results that will vary in each case depending on the facts, including the terms of plan provisions. Nonetheless, leaving aside the possibility that independent institutional fiduciaries may exist, some general patterns exist as to when company employees, officers, and directors may have fiduciary status.

Typically, a committee comprised of company officers or employees acts as a named fiduciary for a plan. As discussed above, the fact that such a committee acts in a fiduciary capacity does not mean that it has any, much less unlimited, fiduciary discretion over whether and when a plan will invest in employer stock. To the contrary, it is common to have plan provisions that require or encourage employer stock investment and common to have the actual investment decisions left either in the hands of the company as plan sponsor to the extent it makes matching contributions in employer stock or of participants who decide whether to invest their own accounts or portions of those accounts in an employer stock fund. Nevertheless, whatever the scope of their fiduciary duties, a named fiduciary committee and its members may have fiduciary status with regard to employer stock investments by the plan.

It is also common to have such a committee report on a periodic basis, ranging anywhere from quarterly to annually, to a committee of the company's board of directors that is charged with, among other duties, oversight responsibilities regarding the company's employee benefit plans. This board committee may also have authority to appoint and remove members of the named fiduciary committee. If so, the board committee and its members will also likely have fiduciary status. Importantly, however, the scope of the fiduciary duties relating to the board committee should be restricted. As a general principle under ERISA, a person is a fiduciary only to the extent he or she is performing a fiduciary function. While the board committee is acting as a fiduciary in performing the functions of appointing, monitoring, and deciding whether to remove the members of the named fiduciary committee, its fiduciary functions—and thus its duties and potential liability—should not extend to whatever other tasks it performs and should not make the board committee directly responsible for the functions performed by the named fiduciary committee, including whatever decisions are made by the named fiduciary committee regarding employer stock.

Stating this principle is easier than applying it in many situations. Plaintiffs in these cases have staked out a broad position that the board committee's duty of monitoring requires the members of that committee to provide to the named fiduciary committee all information they know about the prudence of employer stock as an investment and to act affirmatively to restrict plan investment in employer stock if they know information that would suggest that such investment would be imprudent. Moreover, plaintiffs have not limited their group of defendants to members of committees that have some role in the fiduciary process or oversight. Another general principle in the ERISA case law is that anyone who actually performs a fiduciary function is a fiduciary with respect to that function even though that person has no official responsibility for that function. Using this broad concept of a *de facto* fiduciary, plaintiffs have argued that company officials who may not serve on a relevant committee but may have nonpublic financial information, such as a CEO or CFO, have *de facto* assumed fiduciary roles of appointing or monitoring named fiduciaries. To the extent that plaintiffs can establish the fiduciary status of such persons, they will make arguments for liability similar to those directed at the board committee: that the duties to appoint and monitor fiduciaries bring with them disclosure and other fiduciary duties that may make these *de facto* fiduciaries directly liable for actions taken with regard to an employer stock fund.

Finally, if plaintiffs can establish that any defendant is an ERISA fiduciary, they will argue that that defendant can be held liable under principles of co-fiduciary liability for the acts of other fiduciaries. Section 405 of ERISA describes three circumstances under which one fiduciary can become liable for the acts of another fiduciary. One of those circumstances arises where the co-fiduciary breaches his or her own duties and enables the breach of another fiduciary; the other two circumstances arise only when the co-fiduciary acquires knowledge that another fiduciary is committing a breach but conceals or fails to take reasonable steps to remedy that breach. The case law is split over how broadly these co-fiduciary liability principles should be applied. Plaintiffs and the DOL, however, argue that a co-fiduciary can become liable even where he or she had no responsibility for the fiduciary function or action that constitutes a breach. For example, they would argue, a CEO who becomes a fiduciary by virtue of a *de facto* role in appointing named fiduciary committee members and knows nonpublic information showing that investment in an employer's stock is imprudent should be liable for any breach by the named fiduciary committee even though the CEO's fiduciary status is limited to his or her role in committee appointments.

Again, the case law is at too early a stage to permit any definitive statement about how the courts will react to these efforts to broaden the group of defendants and expand their liability under fiduciary and co-fiduciary principles. The courts have also struggled thus far with the potential intersection between ERISA's fiduciary duties and the prohibitions under federal securities laws on trading on the basis of material nonpublic information. Some courts have held that ERISA should not be held to require or permit actions that would violate securities laws such as a decision by plan fiduciaries to dispose of all company stock held by the plan based on nonpublic information. Other courts have held, however—consistent with arguments by plaintiffs and the DOL—that there may be ways to reconcile the two sets of duties and still take steps to protect a plan without resulting in violations of securities laws.

V. SUGGESTIONS FOR MITIGATING LIABILITY

As discussed, the potential for liability in these cases involves some staggering amounts, ranging into the billions of dollars. Although much remains to be learned through the case law, and defendants will have a number of powerful arguments against any liability, it makes sense at least to consider what steps can be taken that would reduce the potential for expensive and distracting litigation and minimize the chances of facing a large liability. Because this wave of litigation is relatively new, it is impossible to say that any specific steps will be sufficient to achieve those goals even if they are fully implemented. The following steps are among those that could be considered.

A. Plan Design Decisions

It is as close as it gets to settled law under ERISA that an employer's decisions as to what terms a plan should include are made in the employer's nonfiduciary capacity as plan sponsor or settlor. As this wave of litigation shows, however, there is sometimes a thin line between a nonfiduciary settlor decision regarding plan design and fiduciary decisions regarding how best to implement this design. For example, it is obviously a nonfiduciary act to decide that a plan will provide for an employer stock fund and will be structured as an ESOP or other kind of EIAP but, as discussed above, there may still be fiduciary duties with regard to the employer stock acquired by the plan pursuant to such a design.

The threshold decision is whether to permit the plan to invest in employer stock to any significant extent. From a liability viewpoint, the obvious conclusion is that the exposure presented by these types of cases would not exist if the plan were structured to prohibit, or at least limit substantially, plan investment in employer stock. There are, of course, many aspects of such a decision and many reasons why employers want their plans and employees to invest significantly in employer stock. Nonetheless, while this decision is not subject to attack on fiduciary grounds since it is made in a nonfiduciary capacity, employers ought to at least consider what objectives they want to serve by encouraging employer stock investment and how those objectives rank compared to the potential liability exposure.

Assuming that a sponsor does want to encourage substantial investment in employer stock, a number of key design decisions have implications for liability exposure. The most obvious is that the plan must at a minimum be designed as an EIAP. This is a relatively simple task involving the inclusion of plan provisions that expressly permit, with as much specificity as desired, concentrated plan investment in employer stock. Beyond the relatively basic level of drafting necessary to attain EIAP status, a more complicated question is whether all or part of the plan should be designated as an ESOP. The requirements and implications of ESOP status are beyond the scope of this paper and should be carefully considered with expert advisors. As a general matter, however, plaintiffs will argue that EIAPs that are not ESOPs are not entitled to any presumption that it is reasonable to continue holding employer stock.

As a general matter, however, the type of liability exposure presented by the employer stock cases is mitigated to a greater extent the more clearly that the documents require investment in employer stock. A fiduciary of an ESOP or other plan that is required by its terms to be invested in, or to permit participant investment in, employer stock may or may not be fully insulated from fiduciary duties or liability. That fiduciary, however, certainly has stronger arguments for following those documents than a fiduciary who is granted wide discretion over whether and to what extent a plan should be invested in employer stock. For example, even if a court holds that a fiduciary is not required in all circumstances to follow the terms of an ESOP that require exclusive investment in employer stock, it is likely to require a plaintiff to show, not merely that other fiduciaries might have made different investment decisions, but that no prudent fiduciary could have invested in this employer's stock. At the other extreme, a fiduciary who has complete investment discretion over assets of an EIAP that permits, but does not require, investment in employer stock will have to show that an investment in employer stock was at least as prudent a course as making some other investment.

Whatever the terms governing employer stock, they should be expressed clearly in the governing plan and trust documents. In addition, it is important to have those documents reviewed to ensure that these terms are not potentially inconsistent with other terms in the documents. These types of documents frequently evolve over time through amendments and additions. It is important that, for example, if the intent is to require essentially all plan assets to be invested in employer stock, there are not other provisions in the same or another document that might be read as confirming discretionary fiduciary authority to select investments.

A related design decision involves structuring how the employer stock investments are funded. Plans of this type are funded by either or both employee or employer contributions, and the employer contributions may match employee deferrals or contributions up to a specified limit. It is possible to design a plan to provide that specific types of contributions—typically, the employer's matching contribution—must be made or invested in employer stock. Subject to statutory diversification requirements, plan provisions may also require that investments in employer stock not be changed or moved to other investment options. Again, these types of provisions have other implications and objectives that need to be carefully considered with expert advice. Moreover, their impact on mitigation of liability exposure is unclear and possibly mixed. In situations in which companies have sunken into insolvency, plan provisions that effectively required continued investment in employer stock have been criticized as having locked participants into a disastrous investment. On the other hand, the fact that restrictions are contained in plan provisions provides another argument that the fiduciaries acted properly in following plan terms. Different companies may resolve this issue differently, but it is an issue that at least should be addressed.

B. Fiduciary Governance Structure

Deciding how a plan's fiduciary decision-making process should be structured is also a design decision but is worth separate and serious consideration. ERISA requires that some individual or entity have responsibility for each fiduciary function. The objectives of designing a fiduciary structure should include deciding who is best able

to make what decisions, memorializing the structure in clear terms, and making sure that the structure is adhered to so as to minimize the risks that people do not unintentionally become *de facto* fiduciaries. No one can stop a plaintiff from alleging, for example, that a CEO acted as a *de facto* fiduciary even if he or she had no responsibility for fiduciary functions. Adhering to a well-thought-out fiduciary structure, however, should remove much of the risk of liability for people who are not given express fiduciary roles. The structure needs to be clearly memorialized so there is no ambiguity as to what functions are conferred on what persons or committee.

One immediate result of the current wave of employer stock litigation has been the reconsideration by many sponsors of plans that invest heavily in employer stock or decisions about who should serve in fiduciary roles. A sponsor has a full range of options ranging from appointment of a totally independent fiduciary to a committee of senior company executives. Whatever structure is chosen, one conclusion seems clear from the viewpoint of mitigating liability exposure: the more central the involvement of senior officials likely to have nonpublic financial knowledge, the greater the potential for exposure. To address that exposure, a company ought to consider eliminating the involvement of such officials in the plan's fiduciary structure or eliminating or limiting their involvement with the employer stock fund.

The same types of issues will recur as to directors or others who serve on a committee that appoints and oversees the named fiduciary committee. Although it may be impractical to exclude from such a committee anyone who has material nonpublic financial information about the company, the governing documents—which, especially for these purposes, might include corporate bylaws or other formal delegations of authority—should at least be clear about the limited scope of this committee's involvement with the plan and about its primary function of assuring that the named fiduciary committee members are qualified to perform their duties. As part of these documents, a company should consider express exclusion of certain directors and officers from named fiduciary positions.

C. Decisions Concerning Employer Stock

Assuming that the plan language mandates investment in employer stock, it is possible to take the position that there is no room or reason for any fiduciary consideration of the appropriateness of continued investment in employer stock. Some companies may decide, given the unclear state of the law, the strength of the language in a plan's governing documents, and the characteristics of their stock, that there is no reason to consider any action—except following the plan's terms. Others in different circumstances might decide to conduct a periodic fiduciary review of the stock's appropriateness consistent with the judicial decisions, concluding that there is a presumption of reasonableness attached to the plan investment in employer stock. The remainder of this discussion assumes that a decision is made to conduct such a review.

There is no set period for doing such a review. If the plan includes other investment vehicles or options besides employer stock, there is likely already a process in place for reviewing the performance and continued prudence of those investments or options. As a general matter, it would make sense to review the employer stock fund at the

same time and with the same set of criteria. An employer stock fund may necessarily be more volatile in performance than a normal investment benchmark because employer stock is a single security.

The purpose of a periodic review should be to decide if there is any reason to consider departing from the normal presumption in the case of an employer stock fund. In addition to a periodic review, any of a number of events affecting stock price might also trigger such consideration. For example, a sudden sharp drop in stock price or the announcement of some significant adverse event affecting the company might provide such a trigger. If further consideration is triggered by either such an event or a periodic review, then the committee should follow a procedure that it designs with expert advice to determine whether there is any reason to depart from the plan requirement to invest in employer stock. Although there is no set list of factors that should be considered, case law suggests a non-exclusive list of factors, including the current recommendations of investment analysts and the decisions made by independent institutional managers regarding the employer stock, as well as any evidence about whether corporate insiders are buying or selling the stock. The development of such a list will undoubtedly be an evolutionary process as new judicial decisions are issued. Either as part of, or as a separate addition to, this process, the committee should consider whether it would benefit from independent advice or management, especially if the evidence as to continued investment in the stock is inconclusive. If the committee were to conclude that one of the conditions identified in some of the case law as requiring a decision to sell employer stock even in an ESOP was present—such as the impending collapse of the company—it should consult with counsel, including its duties under the securities laws.

D. Communications with Participants

It goes without saying that all communications to participants should be carefully reviewed in order to avoid any misrepresentations about employer stock. In cases involving plans that permit participant election into employer stock, plaintiffs have alleged that employers touted the advantages of employer stock and failed to advise participants of the risk of being in a single-stock fund. Although the case law has not addressed these issues in any meaningful way, an obvious way to counter such allegations is to be able to show that they are not true and that participants were advised of the risks of the employer stock fund and encouraged to consult personal financial advisors regarding their investment decisions.

Whether and how to comply with Section 404(c) is beyond the scope of this paper. Beyond its conditions, however, we do not see the need for any special program of communicating with plan participants, as distinct from investors in the public at large, about company financial issues that may affect stock value. Rather, companies should be aware that whatever is said to employees about the investment merits of company stock may be used as the basis for an ERISA claim.

E. Summary and Checklist

We thought it might be useful to summarize in checklist form our suggestions about mitigating liability and reducing exposure to loss in these cases. We want to emphasize, however, that we are not suggesting that these steps are legally required or that they are certain to avoid loss.

1. Plan Design

- Think carefully about whether and why you want plan investment in employer stock.
- If you want to require substantial plan investment in employer stock, the plan documents should say so clearly.

2. Plan Governance

- Have a clear fiduciary structure and stick to it.
- Consider excluding from fiduciary positions those individuals who are likely to have material, nonpublic information about employer stock.

3. Prudence Review

- Decide whether to periodically review the prudence of continued plan investment in employer stock.
- If a periodic review is undertaken or if a triggering event makes such a review appropriate, develop a list of factors to be reviewed, and follow and update that list.

4. Participant Communications

- Communicate carefully and accurately when discussing employer stock with employees.
- Make sure participants are clearly advised of the risks inherent in an employer stock investment.

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