BENEFITS LAW JOURNAL

Limiting 401(k) Fiduciary Exposure After *Enron*: Put Your Prose to Work

Kevin P. O'Brien and Rosina B. Barker

Current litigation shows the risks of offering employee stock through an ERISA plan. If the stock price falls, the plan's fiduciaries may be sued for fiduciary breach. Fiduciaries, however, are not totally at the mercy of changing stock prices. Litigation brought after the collapse of Enron and other companies shows that fiduciaries can be protected by better plan drafting. Typical plan "boiler-plate" that should be revisited and rewritten includes all provisions describing how the fiduciaries are selected, what the fiduciaries' duties are, and how employer stock is offered through the plan.

Recent stock market turbulence has shown the danger of promoting employee stock ownership through an Employee Retirement Income Security Act (ERISA) plan. Officers and directors now find themselves sued by 401(k) plan participants for the collapse in the value of company stock funds that, according to participants, they had an ERISA fiduciary duty to prevent.

The poster child for 401(k) lawsuits is the ongoing *Tittle v. Enron Corp. (In re Enron Corp. Sec. Derivative & ERISA Litig.)*, 284 F. Supp. 2d 511 (S.D. Tex. 2003). *Enron* has spawned a series of copycat ERISA actions, all involving 401(k) plans that had significant losses in an employer stock fund. At least 12 of these cases have resulted in preliminary published opinions.[1]

Enron and its sister cases already have important lessons for plan

Kevin P. O'Brien and Rosina B. Barker are partners in the Washington, DC, law firm of Ivins, Phillips & Barker. Mr. O'Brien and Ms. Barker specialize in employee benefits and executive compensation. They are contributing editors of *Benefits Law Journal*.

sponsors who wish to defend themselves against similar claims. The *Enron* cases show that a solid defense begins with a well conceived fiduciary structure and protective plan language. Typically drafted as "boilerplate" soon after ERISA's enactment, these plan provisions should now be revisited and rewritten to reflect these new lessons.

One caveat: *Enron*-type litigation is still in its very early stages. The decisions to date are all based on defendants' motion to dismiss. That is, the courts have been asked to decide only whether plaintiffs have enough of an ERISA theory to proceed with a trial. In most cases, the courts have decided that they do. This means the law is still largely undeveloped. For example, for technical reasons, the case law dealing with the protective scope of ERISA Section 404(c)—the fiduciary's defense for funds in which employees have investment choice—is still quite limited.[2] It also means no approach is a fail-safe defense. Nonetheless, even at these early stages there are some obvious steps that can help an employer establish a solid defensive strategy.

PLANNING OBJECTIVES

The starting point for understanding a company's planning objectives is the fiduciary theory urged by the Department of Labor (DOL) in *Enron*: First, the officers who appointed the plan fiduciaries had—by virtue of their fiduciary power to appoint—an ongoing fiduciary duty to monitor the performance of the appointed fiduciaries. Second, as to these "appointing" fiduciaries, the duty to monitor included a duty to inform the appointed fiduciaries about their alleged knowledge of the pending collapse of the company. This double-barreled theory was largely accepted by the *Enron* court.[3]

Taken to its logical extreme, the DOL's theory has a couple of disturbing ramifications: First, the proliferation of fiduciaries, as the mere act of appointment gives rise to an ongoing fiduciary to monitor; and second, the ongoing duty of the appointing fiduciary to inform the plan fiduciary of every piece of insider information that could affect stock price. At its most extreme, this makes the appointing fiduciary a virtual guarantor of the company stock price—a conclusion that DOL officials informally disavow; however, few company officers or directors would be willing to hazard losing it.

Prudent planning first calls for localizing fiduciary liability as much as possible, and then protecting the fiduciaries by means of employer indemnification and by the provision of fiduciary liability insurance.[4] Second, it means insulating the officers with inside information about the company as much as possible from the fiduciaries with information and decision-making power concerning the plan. And third, it means making the act of offering company stock to employees a decision that—as much as possible—is not a fiduciary decision governed by ERISA. To achieve these objectives, the questions that must be addressed are these:

- Who should the employer select as fiduciaries;
- Who should be insulated against fiduciary attack;
- How should the fiduciaries be selected; and
- How can a plan best be drafted to limit the scope of ERISA fiduciary duties when the employer stock is offered as a plan investment.[5]

TYPES OF ERISA FIDUCIARIES

Before getting to specific recommendations, some ERISA basics are required. ERISA sets forth three ways in which a person can become an ERISA fiduciary: (1) a fiduciary can be named in the plan document; (2) a person can be selected to become a fiduciary by another person; and (3) a person can become a fiduciary by acting as such, whether or not otherwise named or selected.

Typically, two fiduciaries are mentioned specifically in the plan document: (1) the "plan administrator" and (2) the "named fiduciary." The "plan administrator" has a number of specific duties under the statute. The plan administrator has responsibility for satisfying the reporting and disclosure requirements of ERISA. This includes the distribution of summary plan descriptions and the filing of annual reports. The plan administrator adjudicates claims under the ERISA claims procedure rules. The plan administrator also has responsibility for satisfying any income tax withholding requirements on plan distributions; this includes the distribution rollover notices. Unless someone else is named as the "plan administrator" in the plan documents, the plan sponsor automatically becomes the "plan administrator."[6]

ERISA also refers to a category of fiduciaries called "named fiduciaries." These are fiduciaries that are either named specifically in the plan document or that are selected pursuant to a procedure set forth in the plan document. The "named fiduciaries" do not have any specific duty under ERISA, but the DOL tells us that an ERISA plan must have at least one "named fiduciary," and that the preferred route is to name the fiduciary specifically in the plan document, rather than picking the "named fiduciary" under a procedure.[7] ERISA allows the "named fiduciary" to allocate pieces of his or her fiduciary duty to delegated fiduciaries. ERISA further provides that the delegating named fiduciary is not responsible for the acts or omissions of the delegee, as long as the original delegation was prudent and remains so thereafter.[8] The ERISA conference report elaborated on the prerequisites of a good delegation of duty by a "named fiduciary" and said that a delegating named fiduciary must "periodically review this person's performance." This "duty to monitor," as it has come to be known, could involve a "formal periodic review," or it could be satisfied through "day-to-day contact and evaluation," or it could include "in other appropriate ways."[9]

The particular status of the "named fiduciary" always has been something of a mystery. While not burdened with any specific statutory duties, some courts have construed the "named fiduciary" as something of a fiduciary "chief of staff" with over arching responsibility for all of a plan's fiduciary operations.[10] This kind of potential super-liability is not something that most plan designers considered when plan documents and operations first were designed to comply with ERISA. Indeed, in ERISA's early years, it was thought preferable to be a "named fiduciary" rather than a selected fiduciary. It was then thought that "named fiduciaries"' could avoid liability by means of delegating responsibility to others, while non-named fiduciaries could not avoid liability by subcontracting their duties to another. This early thinking now needs rethinking. Recent case law has thrown doubt on the premise that the act of delegation rids the delegating named fiduciary of responsibility for the delegated responsibilities.

TYPICAL PLAN STRUCTURE

Against the backdrop of this historical understanding of the role of the named fiduciary under ERISA, it has been common for plans to denominate the "plan sponsor" as both the "plan administrator" and as a "named fiduciary." The statute makes the plan sponsor the plan administrator by default, so it seemed to make sense to articulate this result specifically in the plan document. Also, since the plan sponsor undertakes to set up the ERISA plan and employ a wide variety of experts, administrators, and investment professionals, it seemed sensible to denominate the employer/plan sponsor as the named fiduciary. Finally, many plans picked the plan sponsor as the plan administrator and the named fiduciary as an attempt to shield company employees from possible liability.

This strategy has proved imperfect because most courts have had no problem reaching the conclusion that an employee of a fiduciary may also qualify as an ERISA fiduciary.[11] Also, since many plans describe the company itself as the ERISA named fiduciary and plan administrator, many of these plans specifically involve the company's board of directors or the company officers in the fiduciary picture by having these individuals responsible for picking various fiduciaries, such as the plan trustee or an investment advisor.

The 401(k) cases point out the problem with the typical fiduciary structure we describe.[12] If the company is a fiduciary, then, under the DOL's theory that the duty to appoint gives rise to an ongoing fiduciary duty to disclose, the question arises whether any information known to the employer must be shared with other plan fiduciaries under a duty to disclose. There is also the question whether various company statements about the company's outlook, such as those in SEC filings, are construed as statements of an ERISA fiduciary. Naming the plan sponsor as a fiduciary also exposes all individuals who act on behalf of the company to liability. This includes the board of directors and the top officers of the company. Naming the company as a fiduciary also presents the problem seen in the *Varity* case.[13] In *Varity*, the Supreme Court held that an employee of the plan sponsor could be construed as acting on behalf of the plan sponsor in the employer's fiduciary capacity if a participant reasonably believed it to be so. The typical plan structure leaves too many individuals exposed to fiduciary attack and can be streamlined to reduce risk.

DO'S, DON'TS, AND RECOMMENDATIONS

There are a number of steps that can be taken to reduce the likelihood of class action lawsuits and to reduce the scope of fiduciary liability.

Do Not Name the Employer as Plan Administrator or Named Fiduciary

As noted, if the plan sponsor is a fiduciary, it is difficult to localize fiduciary liability—other parties take on possible fiduciary status. The better approach is to not name the employer as the plan administrator or a named fiduciary.

Many plans have historically adopted the opposite approach—largely because their fiduciary structure was drafted in light of a less evolved understanding of ERISA. Especially under earlier case law, it was not entirely clear whether or not the employer was a fiduciary—if not specifically designated by the plan document. While the courts answered this question in many ways, earlier cases in particular tended to find that the plan sponsor was a fiduciary under a variety of theories that have survived into modern case law. As an example of an arguably surviving theory, fiduciary status has been attributed to a plan sponsor because the sponsor had the power to appoint plan fiduciaries.[14] In addition, however, some early cases held that plan sponsors were fiduciaries because of acts that, under more recent case law, seem more settlor in nature, notably having the power to amend the plan,[15] and owing contributions to a plan.[16]

These cases were decided before the settlor doctrine was clearly developed and have probably been superseded. In *Varity v. Howe*, by comparison, the Supreme Court found that the plan sponsor was a fiduciary because the employer was the "plan administrator" under ERISA.[17] Following the rule suggested by *Varity*, the *Enron* cases have typically found that the plan sponsor is the plan fiduciary only if so named by the plan document.[18]

Despite the uncertainty presented by the case law, in light of the post-*Varity* trend of fiduciary attribution, plan sponsors should consider taking a couple of plan drafting steps to minimize the risk of proliferating fiduciary status among their directors, officers, and agents. First, the plan document should not name the plan sponsor as the plan administrator or as a named fiduciary. Second, because some courts believe that mere act of appointment may itself be fiduciary, the plan document should not vest the plan sponsor with discretion to select plan fiduciaries.

Name Individual Fiduciaries in the Plan Document

Rather than the fiduciary being selected by the board of directors or the chief executive officer, these sorts of high ranking corporate officials can be protected against fiduciary status if the particular fiduciaries are named specifically in the plan document. This can involve naming the person by name or perhaps by job title. The idea, of course, is to make the selection of the fiduciaries a settlor function activity rather than an act of fiduciary discretion.

This approach could be used even if a committee structure is employed. All of the committee members could be named individually or by job title. If this is too cumbersome, the committee chair could be named in the plan document, and that individual could be given the authority to select other committee members.

Limit Selected Plan Fiduciaries to Qualified Individuals Who Are Not Highest Policy Makers

While many companies have a plan committee denominated as the "plan administrator" and the "named fiduciary," those committees often are populated by individuals who also are on the board of directors or who are other top officers of the company. Since these policymaking officials will always know more about the company than anyone else, they fall into the "duty to inform" trap by virtue of who they are. One way around this problem is to name a committee as "plan administrator" and "named fiduciary" while limiting the appointees to competent, and yet not top level, employees of the plan sponsor.

The object of this approach is to erect a "Chinese wall" between the plan committee members and the top policymakers with the company, so as to insulate the plan committee members from any corporate information that could be compromised. This approach probably makes sense only in larger companies who have a sufficient base of qualified candidates.

The idea only works if the selected individuals are named in the plan document and were not selected by another plan fiduciary. If the fiduciaries are appointed by an "in the know" fiduciary and the DOL's *Enron* position becomes the law, a selecting fiduciary is obligated to tell his selectee anything the selectee needs to know to perform his job better.

The Third Circuit's post-*Varity* cases criticizing the use of "Chinese walls" do not necessarily invalidate this approach. These cases hold that a company cannot construct a "Chinese wall" around lower-level company officials to avoid giving accurate information about upcoming plan changes to plan participants. In these cases the plan sponsors were found to be fiduciaries, usually because of "plan administrator" status, and the employee who gave incorrect information about an impending plan change was viewed as an agent of the "plan administrator."[19] The honest, but inaccurate, statement of the agent was treated as if it was made directly by the fiduciary/principal. The case of the "Chinese wall" separating a principal from its agent is far different from the one separating one plan fiduciary from another plan fiduciary.

Consider Appointing Independent Fiduciaries to Monitor Company Stock Fund

A number of commentators have suggested that companies consider hiring an independent fiduciary who would be responsible for ensuring that a company stock fund remains a sound investment choice. Much like the idea of appointing non-policy making corporate insiders, the idea is to place the responsibility over the company stock fund in the hands of someone who has no access to inside company information.

Merely appointing an independent fiduciary, however, is not by itself a protection. As with a committee approach, the key point is who selects the independent fiduciary in the first place. Under the DOL's position, if the independent fiduciary is selected by another "in the know" fiduciary, then the "in the know" fiduciary may be responsible for telling the independent fiduciary what he or she needs to know about upcoming events that may have dire consequences for the company stock fund.

Limit the Responsibility of Selecting Fiduciaries

If a plan document appoints an officer or the Board of Directors as the party responsible for selecting other fiduciaries, the general duties of the selecting fiduciary should be limited to that sole function. A number of the recent 401(k) cases have been dismissed against certain officers or particular board members; these have all cited the fact that the duty of these selecting fiduciaries was limited to that one act.[20] When a duty to select other plan fiduciaries was combined with broader duties, however, the result was different, and the action was not dismissed.[21] In *Rankin v. Rots*,[22] for example, the court was impressed by the fact that the plan document and the attendant Board resolutions provided that the Board of Directors and the plan committee had final authority over investment decisions in addition to their fiduciary appointment powers.

Make Company Stock Fund a Settlor Decision

The typical fact pattern in the recent 401(k) cases involves a plan in which participants can invest their salary reduction contributions in a company stock fund on an elective basis and the matching employer contributions had to be invested in company stock. In many of these plans, the company stock fund was denominated an ESOP, and the plan included language incorporating the statutory definition of the ESOP as a plan designed to invest "primarily" in employer stock. When faced with this "primarily" standard (or similar language), the courts have found that the act of offering a company stock fund has a discretionary element and is therefore fiduciary in nature.

If the intention is to limit the matching contributions to the employer stock fund, then the plan document should be amended to make it clear that no other investment is permitted under the plan. The idea is to make the company stock investment a design feature of the plan which will withstand fiduciary attack under the settlor function doctrine. This means that the "primarily invested" ESOP-type language should be modified so that it is clear that certain amounts must be invested in company stock. Likewise, the plan document should be amended to delete any provision allowing contributions to be invested in cash or cash equivalents. (Provisions allowing for a small amount of cash for "administrative" purposes, however, should not defeat the purpose of these provisions. Such limited language should be read to limit discretion to the very narrow purposes of making distributions and paying expenses, and should not defeat the argument that the decision to offer employer stock is settlor in nature, rather than fiduciary.) Finally, even if the employer stock fund is to be offered as only one investment choice in a 404(c) plan (rather than as a non-elective employer matching fund), the plan document should clearly state that the availability of the stock fund is a required feature of the plan. In this way, the document will make clear that the decision whether to offer the investment is not within the discretionary power of the plan fiduciaries and is instead a settlor decision not subject to ERISA.

Both the *Corning* and the *Dynegy* courts have noted the importance of the particular plan wording in determining the scope of a fiduciary's liability in a plan with a company stock fund. Both courts noted the difference between a plan designed to mandate the investment of certain contributions in employer stock or a plan that mandates the offering of a company stock investment option from a plan that merely states it is designed to invest "primarily" in employer stock.[23] The *Corning* opinion cites the Third Circuit opinion in *Moench v. Robertson*[24] for the proposition that, when an ESOP trust does not mandate investment in the company's stock, then the ESOP fiduciary may be liable for failing to recognize when such investments no longer serve the purpose of the trust. The Third Circuit's opinion in *Moench,* as well as the Sixth Circuit's opinion in *Kuper v. Iovenko,*[25] often are cited for the proposition that ESOP trustees would have to consider investing in something other than employer stock if a strong showing can be made that the plan drafters would not have intended for the employer stock investment given the particular set of circumstances. To our mind, this overstates the holding in the *Moench* and *Kuper* cases since both of these cases involved plans that contemplated other investments because the plan was designed only to invest "primarily" in employer stock. Neither of these plans mandated the investment in employer stock, and it overstates the holding of the cases to suggest that these cases require the disavowal of the plan requirements under any circumstances.

Limit Stockholdings of Individual Fiduciaries

If a plan denominates a named individual or a committee as a plan fiduciary with responsibility over a company stock fund, it is better if the named individuals do not own significant amounts of company stock outside the plan. None of the published cases to date have found the level of a fiduciary's stockholders to present a fatal conflict of interest. A conflict of interest claim has been raised in many of the cases, however, and is one more charge for the fiduciary to defend against. If it is impractical to limit committee appointments to individuals who do not own significant company stock outside the 401(k) plan, then a blind trust should be considered for the stock owned by the fiduciary. The troubling pattern seen in a number of the 401(k) cases involves an alleged fiduciary who sold some or all of his own company stock while the 401(k) plan did not.

Place Employer Stock in a Non-ERISA Trust

Another possible strategy is to maintain the employer stock fund as a separate arrangement from the 401(k) plan. The goal is to be able to argue that the trust holding employer stock—whether contributed as employer matches or discretionary employer contributions—is not a "pension plan" covered by the fiduciary obligations of ERISA Title I. The trust would then be governed by applicable state law. Under the typical state law of trusts, the act of appointing a fiduciary is not itself a fiduciary act and does not give rise to the duty to monitor and the duty to inform that are urged by the DOL for the appointing ERISA fiduciary.

The trick here is to ensure that the employer stock fund is a qualified profit sharing plan under IRC Section 401(a), even though the trust is not governed by ERISA Title I.[26] Under this approach, the employer stock fund would not be labeled or communicated to participants as a "retirement" plan, rather as a stock ownership or incentive plan. All retirement-like features would be eliminated in communications, operations, and design, to the extent permitted by the tax qualification rules of the IRC. Withdrawals, for example, would not be conditioned on termination of employment or attainment of any age but would be permitted as soon as two years after contribution by the employer—the earliest the IRS permits in order for the plan to retain its qualified status.[27] The two-year withdrawal rule is already a common feature of many employer stock plans.[28] The only changes necessary for such plans would be in terminology and employee communications.

No authority expressly supports the idea that ERISA's coverage of an employer stock fund can be severed from its tax-qualified status. Following, however, are the arguments why it might work.[29]

Generally, case law and DOL guidance state that an arrangement is not a pension plan unless amounts are "systematically deferred" until retirement, so providing post-retirement income is more than an "incidental purpose" of the arrangement.[30] The "systematic deferral" must end only with retirement or attainment of a fixed age—not merely with the "passage of a fixed period of time."[31] An arrangement is not a "pension plan" merely because some distributions are paid or made available only after the participant has retired.[32] Rather, case law and guidance look at: (1) whether the arrangement is described by its own documents as a pension plan;[33] (2) whether the arrangement is communicated to participants as a pension plan and administered in order to discourage withdrawals before retirement age;[34] (3) whether payments are unavailable until a specified age,[35] and (4) whether participants in practice tend to defer payments until retirement age.[36]

For example, consider the "Equivalent Ownership Plan" at issue in the recently decided *Bandy v. LG Industries, Inc., Equivalent*

Ownership Plan, 2003 U.S. Dist. LEXIS 12187, 30 EBC (BNA) 2450 (E.D. Penn. 2003). Under the plan, participants were awarded "ownership units" in the company. The ownership units vested after five years of service. The ownership units were not redeemable for cash until the earliest of retirement, death, separation from service, or change of control. Except for its unfunded status, that is, the arrangement looked like a profit sharing or stock bonus plan. The court held that the arrangement was a payroll practice and not an ERISA pension plan, because it was not "created for the purpose of retirement income." In reaching its conclusion, the court noted: (1) the arrangement was described as an "incentive or bonus" plan, rather than a pension plan; (2) the company's officers and participants alike described their understanding of the plan's purpose as to encourage employee retention; and (3) all parties described the plan as a *quid pro quo* for reductions in compensation.

Under the reasoning of the cases culminating in *Bandy*, a qualified plan that (1) allows immediate access to funds after passage of a two-year "fixed period of time," (2) is described a "stock ownership" or "incentive" plan rather than as a retirement plan, and (3) is communicated as part of employees' current compensation package rather than as a pension plan, is a payroll practice not subject to ERISA Title I.

One factor that complicates this conclusion is the uncertain status of IRAs under ERISA. IRA funds are generally available to the IRA holder at any time, albeit with a tax penalty if withdrawn before death, disability, or age 59 1/2.[37] Under the authorities discussed above, the typical IRA arguably lacks enough retirement-like characteristics ever to be considered a Title I pension plan, even if sponsored by an employer. Yet ERISA Section 201 expressly exempts IRAs from the provisions of ERISA Title I, Part 2—unnecessary if no IRAs could be Title I plans.[38] And DOL regulations have created a "safe harbor" setting forth the degree of employer involvement permitted without turning an IRA into a pension plan.[39] By implication under the statute and regulations, some IRAs can be Title I pension plans.

We think this is not a statutory bar to our point. Under the IRC, an employer may sponsor employee IRAs.[40] Although, except for SEP IRAs, employer-sponsored IRAs are allowed to restrict distributions until an employee's retirement.[41] Employer-sponsored IRAs with distribution restrictions may indeed be ERISA Title I pension plans, thus explaining the need for IRA rules under Title I. But it does not follow that all employer-sponsored IRAs are Title I plans.[42]

A handful of cases have concluded that SEP IRAs are Title I pension plans. This is arguably problematic because an IRA with readily available funds (recall that, by statute, SEP IRAs cannot have distribution restrictions) fails at least one factor defining a pension plan.[43] The reasoning of these cases is so cursory, however—based entirely on the fact that SEP IRAs fall outside the DOL's regulatory safe harbor for nonpension IRAs—that they are not a serious obstacle to our point. Moreover, IRAs are distinguishable from the stock funds at issue here. IRAs are labeled by statute and typically communicated to account holders as "retirement" arrangements; thus they satisfy a key indicator of ERISA Title I pension status under guidance and case law. A profit sharing plan or stock bonus arrangement is not described by statute as a retirement plan (except for limited tax penalty purposes) and need not be communicated to employees as a "retirement" arrangement.[44]

Employers interested in this possible approach must continue to file Form 5500 with the DOL for the employer stock arrangement. This will prevent failure-to-file penalties and will not necessarily jeopardize the argument that the arrangement is not a pension plan.[45] In all other respects, the trust would be treated as a trust under applicable state law.

General Barriers to ERISA Litigation

Finally, there are a few issues that could limit the attractiveness of your plan as a target in a class action lawsuit. They were mentioned in a previous article, written by the authors of this article, on cash balance litigation;[46] they apply to the 401(k) context as well and are worth repeating.

1. A forum selection clause makes sense for both benefit claims and fiduciary claims that may be brought on behalf of the plan. There is favorable authority upholding a forum selection clause in a case involving a fiduciary breach claim. In *Frontier Airlines, Inc., Retirement Plan v. Security Pacific National Bank,*[47] the court honored a forum selection clause found in a trust agreement where a plan sued the trustee/custodian. The 401(k) lawsuits are analogous to the *Frontier Airlines* situation since the 401(k) cases typically are brought under ERISA Section 502(a)(2), which involves a claim of relief made on behalf of the plan, rather than on behalf of any particular participant.[48] In other words, a venue-limiting provision does not limit where a plan participant can sue a fiduciary; rather, it limits where the plan itself can bring the action against the fiduciary.

2. There are a number of places that a plan sponsor might want to choose as the locus of any lawsuit. To begin with, it might make sense to limit the jurisdiction to courts that have adopted more narrow interpretations of the ERISA duty to monitor than those set forth in the DOL *amicus* brief in the *Enron* case and in the *Enron* opinion itself. The list of cases adopting a narrower interpretation is longer than many imagine and it

includes the *Corning, Reliant Energy, Sears Roebuck, Worldcom,* and *Williams Company* cases.[49]

3. Also, you might consider amending your plan to cap attorneys fees. As discussed in great detail in our prior article, the goal is to limit the fees paid to any winning attorney to a statutory fee under ERISA Section 502(g), rather than to permit the attorneys to recover a percentage-based fee under the so-called "common fund" doctrine.

CONCLUSION

Enron-type litigation is still in its early stages. Nonetheless, the case law is sufficiently developed to conclude that the boilerplate of the typical plan document may not be sufficient to protect against evolving theories of fiduciary liability for employer stock in an ERISA plan. In line of these trends, employers should consider revisiting and redrafting their provisions for how fiduciary authority is granted and how employer stock is offered as an investment.

NOTES

1. *Hill v. BellSouth Corporation*, 2004 U.S. Dist. LEXIS (N.D. GA 2004); *In re CMS Energy ERISA Litigation*, No. 02-CV-72834, 2004 WL 73735 (E.D. Mich. 2004); *In re Electronic Data Systems Corp. ERISA Litigation*, 305 F. Supp. 2d 658 (ERISA § D. Tex. 2004); *In re Dynegy, Inc. ERISA Litigation*, No. CIV.A.H-02-3076, 2004, WL 540529 (S.D. Tex. 2004); *In re Sears, Roebuck & Co. ERISA Litigation*, 2004 U.S. Dist. LEXIS (N.D. Ill., 2004); *In re Xcel Energy, Inc.*, No. CIV.02-2677, 2004 WL 758990 (D. Minn. 2004); *In re Duke Energy ERISA Litigation*, 281 F. Supp. 2d 786 (W.D. NC 2003); *In re Enron Corporation Securities, Derivative and ERISA Litigation*, 284 F. Supp. 2d 511 S.D. Tex. 2003); *In re Williams Companies ERISA Litigation*, 271 F. Supp. 2d 1328 (N.D. Ok. 2003); *In re Worldcom, Inc. ERISA Litigation*, 263 F. Supp. 2d 745 (S.D.N.Y. 2003); *Rankin v. Rots*, 278 F. Supp. 2d 853 (E.D. Mich. 2003); *Crowley v. Corning, Inc.*, 234 F. Supp. 222 (W.D.N.Y. 2002).

In addition to these cases, there have been a number of similar 401(k) cases that have been settled to date. These include *Kolar v. Rite Aid; In re Providian Financial Corp. ERISA Litigation; Whetman v. Ikon Office Solutions, Inc.*, 209 F.R.D. 94 (I.D. Penn. 2002); *In re Global Crossing, Ltd. ERISA Litigation*.

Other prominent cases are still pending, *Reinhart v. Lucent Texas, Inc.*, No. 01-CV-3491, D.N.J. and *Zafarano v. Nontel Networks Corp.*, No. 3-01-CV 1593 M.D. Tenn. For a list of other cases involving 401(k) lawsuits, *see* "401(k) Litigation Over Company Stock Fund Performance: It's Only Just Begun," Bill Boles, Nancy G. Ross, and Amy Doebring, 15 *Benefits Law Journal* 4 (Winter 2002), 33, 54-55.

2. Very generally, the courts have tended to agree with the DOL that a discretionary fiduciary decision to offer employer stock as one of participants' investment choices in an ERISA Section 404(c) plan is subject to claims for fiduciary breach. The degree to

which ERISA Section 404(c) protects the fiduciary when plan participants avail themselves of that choice is a defense not properly raised at this stage of the pleadings. *See, e.g.*, *In re Dynegy, Inc. ERISA Litigation*, No. CIV.A.H-02-3076, 2004, WL 540529 (S.D. Tex. 2004).

3. *See supra* n.1, *In re Enron*, at 621. The *Enron* court cited the Fifth Circuit case of *Ehlmann v. Kaiser Foundation Health Plan of Texas,* 198 F.3d 552, 556 (5th Cir. 2000) for this principle.

4. We discussed the topic of employer indemnification of fiduciaries in a previous article. *See* "Double Indemnity: Does Your Plan's Fiduciary Indemnification Clause Protect Your Plan Administrator?" 15 *Benefits Law Journal* 3 (Autumn 2002), 5.

5. We previously discussed one element of the matter of ERISA fiduciary status as a result of affiliation with an ERISA fiduciary in a previous article. The article focused on the affiliation rule found in the DOL's "Investment Advice" Regulation, in "Guilt by Association: The Fiduciary Status of Principals, Agents, Officers, Directors and Other Affiliates," 15 *Benefits Law Journal* 2, (Summer 2002), 73.

6. ERISA § 3(16)(A)(ii).

7. 29 C.F.R. § 2509.75-5 (FR-1 and FR-3).

8. ERISA § 402(a)(2); 405(c)(1).

9. CONF. REP 301, 3 ERISA LEG. HIST. 4568.

10. *Leigh v. Engle*, 729 F.2d 113 (7th Cir. 1984); *Birmingham v. Soben-Swiss International Corp. Retirement Plan*, 718 F.2d 525 (2d Cir. 1983); *Arakelian v. National Western Life Insurance Company*, 680 F. Supp. 400 (D.DC 1987).

11. *Stewart v. Thorpe Holding Co. Profit Sharing Plan*, 207 F.3d 1143 (9th Cir. 2000); *Leigh v. Engle*, 727 F.2d 113 (7th Cir. 1984) *contra*; *Confer v. Custom Engineering*, 952 F.2d 34 (3d Cir. 1991).

12. For example, in *CMS Energy*, *supra*, n.1, the employer was both the "named fiduciary" and the "plan administrator." In *Worldcom*, *supra,* n.1, the employer was both the "plan administrator" and the "investment fiduciary." Similar facts are found in *Rots v. Rankin* and the *Sears Roebuck* case, *supra*, n.1.

13. *Varity v. Howe*, 516 U.S. 489 (1996).

14. *Ed Miniat, Inc. v. Globe Life Ins. Group, Inc.*, 805 F.2d 732 (7th Cir. 1986).

15. *Brock v. Self*, 632 F. Supp. 1509 (W.D. La. 1986).

16. *Galgay v. Gangloff*, 677 F. Supp. 295 (M.D. Pa. 1978).

17. *Varity v. Howe*, 516 U.S. 489 (1996).

18. *See, e.g., In re Williams Companies ERISA Litigation*, 271 F. Supp. 2d 1328 (N.D. Ok. 2003) (company not a fiduciary if not so named by the plan).

19. *Taylor v. Peoples Natural Gas*, 49 F. 3d 982 (3d Cir. 1995); *Fisher v. Philadelphia Electric Company,* 994 F.2d 130 (3d Cir. 1993); *Zschunke v. Bell Atlantic Corporation*, 872 F. Supp. 1395 (E.D. Pa. 1995).

20. *In re Williams Companies ERISA Litigation, supra*, n.1; *Hull v. Policy Mgmt. Sys. Corp., supra,* n.1; *Crowley v. Corning, Inc., supra*, n.1.

21. *Rankin v. Rots, supra* n.1; *In re CMS Energy, supra*, n.1.

22. *Rankin v. Rots, supra*, n.1.

23. *Crowley v. Corning, Inc., supra*, n.1; *In re Dynegy ERISA Litigation, supra*, n.1.

24. 62 F.3d 553 (3d Cir. 1995).

25. 66 F.3d 1447 (6th Cir. 1995).

26. If the arrangement is a qualified profit sharing plan under I.R.C. § 401(a), then employer contributions are deductible when paid to the trust and not includible in the employee's income until distributed. *See* I.R.C. §§ 404(a)(3), 402(a). If the arrangement is not qualified under I.R.C. § 401(a), then employer contributions are not deductible before the amount is includible in the participant's income—generally when the contributions vest. *See* I.R.C. §§ 402(b); 83(a)(2); 404(a)(5).

27. Rev. Rul. 71-295, 1971-2 C.B. 184.

28. *See, e.g.,* Summary Plan Description and Prospectus, Lucent Savings Plan, dated Oct. 15, 2000; General Motors Saving-Stock Purchase Program Prospectus, dated Jan. 1, 2004; Sears 401(k) Savings Plan as Amended and Restated Effective as of Jan. 1, 2000, description included Sears, Roebuck & Co. Form 10-K filed with SEC for fiscal year ended Jan. 1, 2000.

29. The following discussion recapitulates some of the points we made, for different purposes, in our previous article, "Limiting 401(k) Fiduciary Exposure After Enron: Put Your Prose to Work," 17 *Benefits Law Journal* 2, (Summer 2004).

30. 29 C.F.R. § 2510.3-2(c) ("pension plan" does not include "payments made by an employer to some or all of its employees as bonuses for work performed, unless such payments are systematically deferred to the termination of covered employment or beyond, or so as to provide retirement income to employees"); Labor Op. 84-12A (Feb, 23, 1984) ("Because the plan does not condition distribution of the amount deferred upon termination of employment retirement or any other circumstances other than the passage of a fixed period of time, the Plan is not by its express terms an employee pension employee plan."); *Murphy v. Inexco Oil Co*., 611 F.2d 570 (5th Cir. 1980) (the plan is an ERISA pension plan only if "payments are systematically deferred to the termination of covered employment or beyond, or so as to provide retirement benefits"); *Oatway v. American International Group,* 325 F.3d 184 (3d Cir. 2003) (stock option incentive plan not a pension plan where "post-retirement payments were only incidental to the goal of providing current compensation"); *Emmenegger v. Bull Moose Tube Company*, 197 F.3d 929 (8th Cir. 1999) (phantom stock plan not a pension plan when plan's purpose was not to defer income, and no evidence that shares were in fact regularly deferred); *McKinsey v. Sentry Ins*., 986 F.2d 401, 406 (10th Cir. 1993) (plan permitting participants to withdraw vested allocations at any time did not provide for "systematic deferral of payment" and therefore was not a pension plan); *Depew v. MNC Financial Inc*., 819 F. Supp. 492 (D. Md. 1993) ("because amounts not systematically deferred to the termination of covered employment," program is a "bonus program" payroll practice, rather than ERISA pension plan); *Hagel v. United Land Co*., 759 F. Supp. 1199 (E.D. Va. 1991) (similar); *Bandy v. LG Industries, Inc. Equivalent Ownership Plan*, 2003 U.S. Dist. LEXIS 12187, 30 EBC (BNA) 2450 (E.D. Penn. 2003).

31. Labor Op. 84-12A (Feb 23 1984).

32. *Oatway, supra* n. 30, at 188, *Murphy, supra* n. 30, at 576; *Bandy, supra* n. 30, at 4 [Lexis pagination]*; Depew, supra* n. 30, at 496; *Hagel, supra* n. 30, at 1202.

33. *Freund v. Marshall & Ilsley Bank,* 485 F. Supp. 629, 634 (W.D. Wis. 1979); *cf. Lachapelle v. Fechtor, Detwiler & Co.*, 901 F. Supp. 22 (D. Me. 1995) (declining to decide if a SEP IRA is "pension" plan—holds it is not a welfare plan, because the SEP-IRA (1) called it a "pension" plan and (2) it was not set up to provide the benefits listed in statute or regulations defining a welfare benefit plan).

34. *Freund,* 485 F. Supp. at 634 (the savings arrangement is a "pension plan," even though funds are available at any time, because "the plan document which was distributed to employees is itself persuasive evidence not only of the companies' promise to provide retirement funds but also of their attempts to encourage employees to leave their funds in the Plan for retirement"); Labor Op. 81-18A (plan must be communicated to participants as a pension plan); Labor Op. 90-17A (June 25) (similar).

35. Labor Op. 99-01A (University "voluntary separation plan" is a pension plan where the lump sum is available only if the employee completed 20 years of continuous service and attained age 60, or older, making it "indirectly contingent on retirement"); *Petr v. Nationwide Mut. Ins. Co.*, 712 F. Supp. 504 (D. Md. 1989) (pension plan where benefits became due in installments after death, disability, or termination, but in any case not before Petr reached age 50).

36. Labor Op. 83-46 A (Sept. 8, 1983) (there may be a pension plan in practice if "distributions under a program are skewed toward the last years of the participants' careers"); Labor Op. 98-02A (Mar. 6, 1998) (the arrangement can be a pension plan if communications to the participants "result in their deferring receipt of income until retirement"); *Murphy v. Inexco Oil Co.*, 611 F.2d 570 (5th Cir. 1980) (the actual practice of "systematic deferrals" needed for pension plan); *Emmenegger v. Bull Moose Tube Company*, 197 F.3d 929 (8th Cir. 1999) (the phantom stock plan not a pension plan in part because there was no evidence that shares were in fact regularly deferred). For guidance that looks at all these factors together, *see* Labor Op. 98-02A (March 6, 1998) ("Thus, if payments under a plan are, in operation, systematically deferred until the termination of employment or retirement age, in such case, the plan may be deemed to be a pension plan. For example, the manner in which bonus percentages are negotiated by employees yearly may allocate the economic benefits earned in a year disproportionately to retirees and participants reaching retirement age as defined under the Plan; an inordinate percentage of the bonus recipients may be at one time at or nearly at retirement age; and payments may not be made under the plan often enough or within a reasonable time to avoid their actually serving as retirement income. Furthermore, if the plan is communicated to participants in a manner that causes them to act under the Plan so as to result in their deferring receipt of income until retirement, it may be deemed a pension plan").

37. I.R.C. § 72(t).

38. ERISA § 201(6).

39. DOL Reg. §§ 2509.11-1, 2510.3-2(d).

40. I.R.C. § 408(c).

41. I.R.C. § 408(k)(4).

42. Also, ERISA § 4(c) delineates which Title I rules apply to "deemed" IRAs and Roth IRAs under pension plans and which rules do not apply. ERISA § 4(c) is entirely ambiguous as to its statutory inference. It can be read as extending Title I status to IRAs that are not otherwise Title I plans or as circumscribing Title I with respect to those IRAs that otherwise are. *But see* Labor Op. 77-22 (Employer-sponsored IRA is pension plan).

43. *Cline v. The Industrial Maintenance Engineering & Contracting Co.*, 200 F.3d 1223 (9th Cir. 2000) (employer-sponsored IRAs—pension plan); *see also Garratt v. Walker,* 121 F.3d 565, 569 (10th Cir. 1997) (SEP-IRA is ERISA pension plan because under DOL regulations, IRA is pension plan if it has employer contributions, and SEP-IRAs were created for purposes of allowing employer contributions to an IRA); *But see Lachapelle v. Fechtor, Detwiler & Co.*, 901 F. Supp. 22 (D. Me. 1995) (declines to decide if a SEP IRA is a "pension" plan, and also holds it is not a welfare plan, because a SEP-IRA (1) is called a "pension" plan and (2) is not set up to provide the benefits listed in statute or regulations defining a welfare benefit plan).

44. *See*, however, I.R.C. § 72(t) and 4974(c), which include any plan qualified under I.R.C. § 401(a), including a stock bonus or profit sharing plan, as a "qualified retirement plan" for purposes of the tax penalty provisions of those sections.

45. *Stern v. International Business Machines Corp.*, 326 F.3d 1367 (11th Cir. 2003). (If a plan qualifies for statutory exemption from an ERISA "plan," the employer cannot turn it into an ERISA plan by calling it one and filing form 5500.)

46. "Cash Balance Emergency Preparedness Kit: This Is Not a Test," Vol. 17, 1 *Benefits Law Journal* 5, (Spring 2004).

47. 696 F. Supp. 1403 (D.Ca. 1988).

48. *Massachusetts Mutual Life Insurance Co. v. Russell*, 473 U.S. 134 (1985).

49. *Supra*, n.1.

Reprinted from *Benefits Law Journal*, Volume 17, Number 3, Autumn 2004, pages 16-31, with permission from Aspen Publishers, New York, NY, 1-800-638-8437, www.aspenpublishers.com.