ERLJ Summer text 04 5/11/04 10:19 AM Page 16

The Good, the Bad, and the Ugly: Delegating Fiduciary Responsibility After Enron?

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In the wake of the collapse of Enron, WorldCom, Kmart, and other large corporations, the federal district courts have applied a laser-like focus to the questions of who is an ERISA fiduciary and why corporate officials may (or may not) enjoy fiduciary status. As James P. Baker explains in this article, what has become apparent from recent court decisions is that a court reviewing an employee benefit plan disaster will carefully sift through the governing plan's language concerning the allocation and delegation of fiduciary responsibility to determine who is a plan fiduciary, and who is potentially liable to make good the retirement plan's losses.

In the wake of the collapse of Enron, WorldCom, Kmart, and other large corporations, the federal district courts have applied a laser-like focus to the questions of who is an ERISA fiduciary and why corporate officials may (or may not) enjoy fiduciary status. How does someone become a fiduciary to a retirement plan? Fiduciaries are, of course, people who stand in a position of trust representing the best interests of retirement plan participants. They are usually responsible for controlling or managing a retirement plan's assets or operations. The federal law regulating retirement plans, the Employee Retirement Income Security Act of 1974 (ERISA) states fiduciary status can be acquired in three ways:

1. Being named as a fiduciary in the instrument establishing the employee benefit plan;

2. Being named as a fiduciary pursuant to a procedure specified in the plan documents, for example, being appointed an investment manager for a retirement plan brings with it ERISA-regulated fiduciary duties; and

3. Being a "functional" fiduciary.[1]

The ERISA statute defines "fiduciary" not in terms of formal trusteeship, but in functional terms of control and authority over the plan.[2] An

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ERLJ Summer text 04 5/11/04 10:19 AM Page 17

ERISA "functional" fiduciary according to the federal courts, includes anyone who exercises discretionary authority over the plan's management, anyone who exercises authority or control over the plan's assets, and anyone having discretionary authority or responsibility in the plan's administration.[3]

Whether or not a person is a fiduciary is of critical importance. When economic disasters befall companies and retirement plan accounts become worthless, ERISA fiduciaries can be held personally liable to make good retirement plan losses resulting from their actions or from their inactions.[4]

What has become apparent from the recent decisions in *Kmart, WorldCom,* and *Enron* is that a court reviewing an employee benefit plan disaster will carefully sift through the governing plan's language concerning the allocation and delegation of fiduciary responsibility to determine who is a plan fiduciary, and who is potentially liable to make good the retirement plan's losses.

THE GOOD?

Being identified in a retirement plan document as a named fiduciary is not economic hemlock, nor does it automatically trigger personal liability for a retirement plan's losses. In *Hull v. Policy Management Systems Corporation*,[5] the plan documents provided that the company was the named fiduciary and a committee was empowered with plan investment responsibilities. The federal court carefully evaluated the plan's language about who did what. The plan stated that other than the power of appointment and removal, the company's board had no other plan responsibilities.[6] As a consequence of this plan language the court decided to dismiss the action against the company's Board and its CEO explaining that the "no other responsibilities" plan language mandated this result when coupled with plaintiff's failure to assert that defendants functioned as ERISA fiduciaries.[7]

A little good language, however, is not always enough. Language expressly limiting the board's authority concerning the plan may backfire if language in other plan instruments contradicts it. Trust agreements, for example, must be consistent with other plan documents in order to effectively allocate fiduciary duties. When plan and trust documents clash in identifying who has a plan's investment policy responsibility, a court may be forced to conclude that everybody is an investment fiduciary. For example, the *In re McKesson* saga began in 1999 with the merger of McKesson Corporation and HBO & Company (HBOC). Within months of the merger, McKesson publicly announced

ERLJ Summer text 04 5/11/04 10:19 AM Page 18

that the company had engaged in improper and illegal accounting practices, had materially misrepresented the financial condition of the company and that financial results would be restated downward. When the price of McKesson's stock subsequently collapsed with the public disclosure of HBOC's improprieties, the corresponding loss in value to the shares of McKesson HBOC stock held in the company's retirement plans was estimated to exceed $800 million. Lawsuits then rained down on McKesson, some alleging breach of fiduciary under ERISA. The ERISA lawsuits named the McKesson Board of Directors, and others, as fiduciaries of the McKesson Plan personally liable to make good the Plan's losses. The McKesson Board asserted that plaintiffs' case should be dismissed because the plan's language contained a "get out of jail" free provision for Board members. The district court, however, refused to dismiss the ERISA fiduciary breach claims against McKesson's board members even though the plan document only identified the plan's administrative committee with investment responsibilities. This argument that relied on express plan language was ultimately rejected because the master trust document identified McKesson's board as responsible for determining the investment policy to be implemented by the Plan's administrative committee.[8]

Expressly delegating investment responsibilities in the plan document may be a good alternative. In *In re Williams Companies ERISA Litigation*, the plaintiffs teed up the familiar WorldCom fiduciary breach claims. They alleged defendants' failure to disclose accurate information about Williams' stock and defendants' alleged failure to prudently monitor and to prudently divest the plan's investment in Williams' stock resulted in large plan losses.

The Williams companies however, did things a little differently. The board appointed members of a benefits committee, which in turn appointed members of an investment committee.[9] The court dismissed the company and the board of directors from the lawsuit but denied a motion to dismiss by the benefits committees. The plan document contained "get out of jail free" language for the company and the board. The plan language employed by Williams attempts to assure that responsibilities of various persons are distinct and separate so as to prevent co-fiduciary liability. Specifically, the plan provided:

To prevent any two parties to the Plan from being deemed co-fiduciaries with respect to a particular function, both the Plan and Trust Agreement are intended, and should be construed, to allocate to each party to the Plan only those specific powers, duties, responsibilities, and obligations as are specifically granted to it under the Plan or Trust. . . . The Plan is intended to allocate to each named fiduciary the individual

ERLJ Summer text 04 5/11/04 10:19 AM Page 19

responsibility for the prudent execution of the functions assigned to it, and none of such responsibilities or any other responsibility shall be shared by two or more of such named fiduciaries unless such is provided for by a specific provision of the Plan.[10]

The Williams Companies' benefits committee, however, had been given broad powers, including the power to amend the plan, to approve any merger or spin-off of the plan, to appoint or remove the trustee, investment managers, the administrative committee or any member of the investment committee and to delegate fiduciary responsibilities to other entities including the investment committee. The investment committee had the duty of monitoring investment objectives, recommending investment options to the benefits committee and recommending investment managers. Looking to the plan provisions, the court summarily dismissed claims against the company, saying it was acting as settlor, and against the board of directors because the board's power was limited to the power to appoint and remove benefits committee members.[11] The *Williams* plaintiffs, however, have asked the court to reconsider its dismissal of the company and its board of directors.[12]

THE BAD

HSBC

Lawyers like to say that bad facts make bad law. Suffice it to say that in the HSBC Bank, Kmart, WorldCom, and Enron cases, there are a lot of bad facts. Transactions involving ERISA plan assets which require Board authorization or approval generally result in the Board being found by a court to be an investment fiduciary. In *Beam v. HSBC Bank USA*,[13] employee stock ownership plan (ESOP) participants of a bankrupt paper manufacturer sued the company's outside directors, alleging they breached their fiduciary duty by allowing the ESOP to purchase $25 million of overvalued stock. The ESOP stock was acquired in a leveraged transaction which increased the ESOP's stock ownership in the company from 19 percent to 57 percent. The transaction was financed through a bank loan after the Board authorized the ESOP's trustee to borrow the funds required to complete the transaction. Citing ERISA's functional definition of a fiduciary the court found the loan authorization constituted sufficient "control" over the disposition of plan assets to find that Board members could be held liable as ERISA fiduciaries.[14] The court further noted that the company's outside directors had

ERLJ Summer text 04 5/11/04 10:19 AM Page 20

fiduciary duties with respect to the appointment, monitoring and removal of the ESOP's trustee and named fiduciary. Fortunately the court refused to make a final determination on the scope of the outside directors' fiduciary status at such an early stage in the litigation.

Kmart

Shortly after Kmart's economic fortunes withered and the price of Kmart stock collapsed, a flurry of lawsuits blanketed Kmart and its officers alleging fraud and breach of fiduciary duty. In the lead ERISA class action case, *Rankin v. Rots*,[15] plaintiffs' alleged that Kmart's former CEO, its outside board members, and the members of Kmart's retirement plan investment committee breached their fiduciary duties by failing to prudently investigate and monitor the merits of continuing to invest in Kmart stock. According to plaintiffs' theory, Kmart stock should have been discontinued as a plan investment vehicle when these fiduciaries knew or should have known prior to the collapse that the stock's price was unsustainable. Kmart's 401(k) plan was designed to provide benefits based solely on the amounts contributed by the participants and through matching contributions made by Kmart. The matching contributions were made to an Employee Stock Ownership Plan (ESOP), which invested primarily in Kmart stock. The plan also required that matching contributions made to each participant's account be invested in Kmart stock until he or she reached age 55 and had been a participant for five years. These restrictions on the Kmart stock held by the plan were not removed until February 2002. Unfortunately, by that time, Kmart stock became worthless. The second fiduciary breach alleged by plaintiffs was for failing to provide accurate information to the plan's participants about Kmart's true financial condition. Finally, plaintiffs alleged the Kmart fiduciaries breached their fiduciary duties by failing to disclose material information.

The plan documents gave Kmart the power to appoint investment managers and the authority to delegate any of its powers to other persons or committees. The Kmart Board duly adopted resolutions under which an investment committee was established. The members of the investment committee could be appointed or removed by the Kmart Board or finance committee. However, the resolutions further stated that the Kmart Board retained the responsibility to take action on recommendation from the investment committee.

Although Kmart had delegated the role of plan administrator and the responsibility for managing the investment to the investment committee, the court found that the investment committee could only make

ERLJ Summer text 04 5/11/04 10:19 AM Page 21

recommendations about investments to the Kmart board. Because the Kmart Board retained final approval over plan investments, the court ruled the Board was an investment fiduciary potentially liable for plaintiffs' claims under ERISA. The express plan language giving the Kmart Board final investment approval concerning investments was determinative:

This is not a situation where the Plan Documents simply provide the board of directors' powers are limited to appointing, retaining and removing members of a benefits committee. In that circumstance, courts have dismissed ERISA breach of fiduciary claims based on allegations of improper investment decisions against members of the board of directors because of the limited role of the board of directors in relation to the plan.[16]

Although the court acknowledged that the facts may eventually show that Kmart's CEO and Board were not fiduciaries with respect to certain plan transactions or investments, the court ruled that the broad authority given to the Kmart CEO and Board, as embedded in the plan's terms, precluded the court from summarily dismissing the plaintiff's fiduciary breach claims.

THE UGLY

WorldCom

While failing to effectively delegate fiduciary duties is bad, not delegating at all is worse, as demonstrated by the *In Re WorldCom, Inc. ERISA Litigation*.[17] WorldCom became infamous in 2002 by announcing that it had improperly capitalized more than $3.8 billion in ordinary expenditures, and had overstated earnings from 1999 though the first quarter of 2002 by approximately $3.3 billion. The price of WorldCom stock suddenly and predictably collapsed following these disclosures and WorldCom filed for bankruptcy protection shortly thereafter.[18] WorldCom was the sponsor of the WorldCom 401(k) Salary Savings Plan. Among the different funds in which WorldCom plan participants could invest were several which invested in whole or in part in WorldCom stock; however, under the terms of the WorldCom plan, investments in WorldCom stock were not restricted and participants were free to continue or eliminate their investments in WorldCom stock at anytime.

The WorldCom plan's delegation language is what ERISA lawyers call, "Less Than Optimal." It identified WorldCom as the named fiduciary, the

ERLJ Summer text 04 5/11/04 10:19 AM Page 22

plan administrator and the investment fiduciary and charged WorldCom with the responsibility for overseeing and reviewing the status of investment alternatives and the investment policy. To make matters worse, the plan's default mechanism stated if WorldCom failed to appoint individuals to carry out duties of plan administrator or investment fiduciary, "any officer" of WorldCom would have the authority to do so.[19] Ouch.

Predictably, the *WorldCom* plaintiffs' argued that "any officer" meant "all officers" and they sought to impose fiduciary liability on every person they could think of; who had any conceivable relationship to the WorldCom plan including the CEO, CFO, board of directors, trustee, accounting firm, various corporate officers (such as the vice-president of human resources), the tax director, and the benefits manager. The plaintiffs' claimed a defendant breached their fiduciary duties under ERISA by allowing Worldcom stock held in the WorldCom plan to become worthless. Indeed, the heart of the plaintiffs' allegations against WorldCom's fiduciaries throbs with assertions that these fiduciaries disseminated materially false and misleading public statements about WorldCom during 1999, 2000, 2001, and 2002 that allegedly fooled plan participants about the true value of WorldCom stock.

Faced with unlimited plan language and a host of potential plan fiduciaries, the court weeded through the list of defendants by applying ERISA's functional fiduciary test. The court ultimately decided that WorldCom's former president and CEO, Bernie Ebbers, as well as WorldCom's former employee benefits director, Dona Miller, could be sued as ERISA fiduciaries. In connection with the finding, the court allowed numerous fiduciary breach claims to continue against Ebbers; including the alleged failure to monitor the plan's other fiduciaries, failure to disclose material facts to the plan about WorldCom's financial condition, and for making material misrepresentations about the soundness of WorldCom stock contained in SEC filings.

The court, however, ultimately rejected the *WorldCom* plaintiff's arguments that because WorldCom was identified as the plan administrator and the plan's investment fiduciary the members of WorldCom's Board were automatically ERISA fiduciaries. Plaintiffs' legal argument that the law in the state of WorldCom's incorporation (Georgia) provided that all corporate powers and affairs are managed under the direction of the board and should automatically translate into personal liability for individual WorldCom board members under ERISA was rejected. Based on this theory, plaintiffs argued that WorldCom Board automatically had the power to appoint investment fiduciaries and the appointment power carried with it a duty to monitor the performance of the appointee. The court disagreed and dispensed with the fiduciary

ERLJ Summer text 04 5/11/04 10:19 AM Page 23

claims against the WorldCom board, stating that plaintiffs' argument "goes too far" and would make any supervisor of an ERISA fiduciary also an ERISA fiduciary.[20]

Enron

A litigant quickly realizes a court is not happy with the way things turned out when it writes a 331 page opinion. On September 30, 2003, a federal district court considering the collapse in the price of Enron stock and its catastrophic impact on the retirement plan accounts of Enron employees, did just that. Why did the *Enron* court decide that members of Enron's board of directors may be personally liable to make good on these huge plan losses? Bad plan language. The Enron 401(k) Plan and Enron employee stock ownership plan identified "Enron" as being responsible for appointing and monitoring the performance of the plans' investment fiduciaries.

The federal court's decision in *In re Enron Corporation Securities Derivative ERISA Litigation*,[21] largely adopted the Department of Labor's expansive views on fiduciary liability. Enron's outside board members argued they were not responsible for the retirement plan's losses because the plan documents did not vest the Board with the power to appoint investment fiduciaries. The Enron court ruled, however, that because Enron Corporation was identified in the plan documents as having the power to appoint, it could only exercise this power through Enron's board of directors. The Board's power of appointment was found by the Court to also carry with it the duty to monitor the investment fiduciaries' activities. Having decided Enron's outside board members were fiduciaries, the Court then concluded these Board members may be legally liable for co-fiduciary breaches if they knew or should have known about the breaches of other Enron fiduciaries.

HOW DOES A BOARD DODGE THE FIDUCIARY BULLET?

Stay out of the way. A company's board should not be identified in the plan document as an ERISA fiduciary nor should it or its members "function" as one.[22] The appointment and removal of Investment Committee members should be embedded in the Plan's terms or vested in a company executive (the Appointing Executive). An Appointing Executive acts as an ERISA fiduciary when he or she appoints or removes members of the Investment Committee. To fulfill this fiduciary responsibility, the Appointing Executive needs to assess whether the appointment of Investment Committee members remains prudent.[23a] In

ERLJ Summer text 04 5/11/04 10:19 AM Page 24

other words, after the appointment of the members of the Investment Committee, the Appointing Executive should periodically review the performance the Investment Committee against the Plan's stated investment objectives. However, the Appointing Executive should refrain from second-guessing the Investment Committee's investment decisions nor should he or she participate or function as an Investment Committee member.

A review of the composition of the Investment Committee membership normally occurs as a result of a personnel change. For example, if a member terminates employment or resigns from membership, the Appointing Executive should evaluate whether and when a new member should be appointed. The Appointing Executive may, for example, determine that there must be at least three members of the Investment Committee at any one time, and that at least one of the members must be intimately familiar with the 401(k) Savings Plan investment options so as to effectively monitor the investment options available to participants. If the Appointing Executive learns that an Investment Committee member should be removed, then the Investment Executive must take timely and deliberate action so as to protect the interests of the plan's participants.

In the ware of *Enron,* reading an ERISA plan's terms and identifying who has been given fiduciary responsibilities is of paramount importance. Plan fiduciaries who fail to heed *Enron's* lessons may find themselves consigned to relive Enron's mistakes.

NOTES

1. 29 U.S.C. § 1102(a)(2); Glazier & Glassworkers v. Newbridge Securities, 93 F.3d. 1171, 1179 (3d Cir. 1996).

2. Mertens v. Hewitt Associates, 508 U.S. 248, 262 (1993).

3. Credit Managers Association v. Kenesaw Life & Accident Insurance Company, 809 F.2d 617, 625–626 (9th Cir. 1987).

4. 29 U.S.C. § 1109.

5. 2001 U.S. Dist. LEXIS 22343 (D.S.C. Feb. 9, 2001) (unpublished).

6. *Id.* at *17–18.

7. *Id.* at *7–13.

8. *In re* McKesson HBOC, Inc. ERISA Litig., No. C00-20030RMW, 2002 WL 31431588 at *9–10 (N.D. Ca. Sept. 30, 2002).

9. *In re* Williams Companies ERISA Litigation, 271 F. Supp. 2d 1328 (N.D. Okla. 2003).

10. *Id.* at 1334.

ERLJ Summer text 04 5/11/04 10:19 AM Page 25

11. *Id*. at 1338–1339.

12. On July 24, the Williams plaintiffs filed a motion for reconsideration or, alternatively, a motion for leave to amend their complaint, contending they sufficiently claimed that the directors breached their duties to provide information to the benefits committee and to monitor the benefits committee "and that these duties arise out of the Board's power to appoint, retain and remove the Benefits Committee." *In re* Williams Companies ERISA Litigation, No. CV-153-H[M] [lead case], Document #54-0300909-046M. On August 22, 2003, the DOL filed an amicus curiae brief joining the plaintiff's motion to reconsider, arguing that plaintiff's complaint sufficiently alleged that the Board filed to properly discharge its duty to monitor the plan's fiduciaries. *Id.* at Document #54-030909-049B.

13. Beam v. HSBC Bank USA, No.02-CV-0682E(F), 2003 U.S. Dist. LEXIS 15744, at *1 (W.D.N.Y August 19, 2003).

14. *Id*. at *9 (the Board members, including the Outside Directors, were fiduciaries because they authorized the Trustee to borrow the funds required for the [ESOP] to enter into the Stock Sale.); *citing* Keach v. U.S.Trust Co., N.A., 234 F. Supp. 2d 872, 882–883 (C.D. Cal. 2002) (holding that outside directors were fiduciaries because they, inter alia, "adopted a resolution approving the concept of the proposed ESOP transaction and authorizing [the company's officers] to take all steps necessary to complete the transaction"); Mohler v. Unger, 1994 WL 1860578 at *16 (S.D. Ohio August 26,1994) (holding that an inside director was a fiduciary based on her "discretionary control of the plan through her actions in approving the ESOP Loan and leveraged buyout").

15. Rankin v. Rots, 278 F. Supp. 2d 853 (E.D. Mich. Aug. 20, 2003).

16. *Id*. at 872.

17. 263 F. Supp. 2d 745 (S.D. N.Y. 2003).

18. *Id.* at. 752.

19. Section 14.02 of the WorldCom plan provides in pertinent part, that "If WorldCom does not appoint individuals to carry out the duties of the Administrator or Investment Fiduciary . . . then any officer of WorldCom, Inc. shall have the authority to carry out, on behalf of WorldCom, Inc., the duties of the Administrator and the Investment Fiduciary." *Id*. at 754.

20. *Id.* at 754, 760 (also indicating that DOL regulations which plaintiff tried to rely upon do not purport to make supervisors of fiduciaries also fiduciaries).

21. 284 F. Supp. 2d 511 (S.D. Tex 2003).

22. ERISA defines "fiduciary" in functional terms. *See* 29 U.S.C. § 1002(21).

23. *See* DOL Reg. § 2509.75-8, FR-17.