

So You Think You Are Safe? Board Members & Personal Liability under ERISA

By Mark Poerio and Eric Keller

Here are five simple questions for which you should know the answer if you serve on the board of directors of a company that sponsors a 401(k), pension, ESOP, or other tax-qualified retirement plan:

1. Who is the trustee of your retirement plan?
2. Who is the plan's administrator?
3. Which of the above, or another, makes investment decisions relating to the plan?
4. Where are we tracking and documenting compliance with the fiduciary duty rules that ERISA applies to our plan, our company, its executives, and us?
5. Are we potentially subject to personal liability under ERISA for failing to monitor all of the above?

The key word above is ERISA, which is short for the US Employee Retirement Income Security Act of 1974. Although often criticized as being too much of a shield for employers, ERISA nevertheless has teeth that mainly come from the application of fiduciary (trust) principles to those who make administrative and investment decisions relating to retirement and welfare plans. Corporate boards would seem a step removed from responsibility for these matters. They are not.

Under ERISA, the appointment of plan administrators and trustees is itself a fiduciary function—one for which most boards of directors or a committee of board members is solely responsible.

Regardless of who has responsibility (assumed below to be directors), these fiduciary appointments must be done with prudence, diligence, and an absence of conflicts of interest.

Perhaps more importantly, well-established fiduciary principles establish a duty to monitor those fiduciaries whom directors may appoint. In this regard, the Department of Labor requires oversight “in such manner as may be reasonably expected to ensure that their performance has been in compliance with the terms of the plan and statutory standards...”

The duty to monitor does not go so far as to require examination of every action taken by the appointed fiduciary. However, there are many court decisions recognizing the fundamental principle that the appointing fiduciary must “take prudent and reasonable action” to determine whether the appointed fiduciary is fulfilling its fiduciary obligations.

A failure to properly monitor is a classic breach of fiduciary duty, and one that is often aimed at corporate boards of directors. For example, Enron's board members became named defendants in its 401(k) “stock drop” litigation, and the same claims have been alleged against Board members of American Express, Avaya, Citigroup, Corning, Merck, Schering Plough, and US Airways (to name just a few of the many who were subject to reported case decisions).

Board members who appoint ERISA fiduciaries should certainly be aware of the directors and officers (D&O) insurance that their company provides. Often, it takes a special ERISA claims rider to assure coverage for directors in their personal capacity. Their best defense is nevertheless precautionary. Because most ERISA litigation turns on whether a fiduciary is able to show procedural diligence (in the sense of taking prudent steps, regardless of the

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outcome), boards of directors should strongly consider the following three basic procedures by which to demonstrate their monitoring of ERISA fiduciaries:

- Establish an ERISA Fiduciary Charter—This may provide a roadmap for who does what, and when, in order to satisfy ERISA fiduciary obligations. It places a premium on having each fiduciary be accountable for their enumerated duties, with a well-considered charter enabling board members to better identify who and what they need to monitor.
- Require an Annual Report from Each Plan Fiduciary—Boards should require a written report, at least annually, in order to hold each fiduciary accountable for properly discharging their duties under ERISA (as delineated in any applicable ERISA fiduciary charter, plan documents and written service agreements with the fiduciary).
- Notification of Extraordinary Events—Boards should have a protocol (which could be built into an ERISA fiduciary charter) requiring that ERISA fiduciaries notify the Board about extraordinary events that could reasonably be expected to cause material adverse harm to the plan's assets or participants. An example would be a plan service provider unexpectedly ceasing operations.

Reports of extraordinary events will better protect Board members because some courts have suggested that annual monitoring alone might be insufficient in certain circumstances. Boards should also consider taking other measures blessed by the courts as adequate such as reviewing administrative committee meeting agendas and having periodic discussions with committee members regarding plan operations and investments.

When ERISA litigation strikes at the board level, the types of measures described above

have proven successful. For instance, claims were dismissed against Merck's Board members who did not serve on its compensation committee, because that committee's charter and the plan's governing documents made it clear that the compensation committee appointed the plan's administrative committee and, therefore, the other Board members did not have any applicable fiduciary authority . . . or consequent duty to monitor. Claims were dismissed against Motorola's directors because they reviewed each appointed fiduciary's performance annually before they were re-appointed to serve an additional one-year term and arranged for the Board's external auditor to review the performance of the plan and report to the Board on anything out of the ordinary.

Conclusion

Board members may sense that the weeds of ERISA plans are far beyond their province. Unfortunately, personal liability awaits those who are hands-off to the point of being unable to demonstrate that they adequately monitored the ERISA fiduciaries whom they have appointed. Because ERISA cases so often turn on whether there was procedural diligence, directors should consider implementing the three basic precautions noted above. These steps, plus adequate D&O insurance, should protect board members from the legion of retirement plan participants who increasingly look to ERISA litigation for recovery when their plans lose money or stumble in their administration.

Board members could go even further, of course, by amending a plan's formal documents to require that an officer or other non-Board member appoint ERISA fiduciaries. This should remove the Board from further fiduciary responsibility. The person or committee who becomes responsible for appointing ERISA fiduciaries will then be on the hot seat to monitor.