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# REAL LIFE FIDUCIARY DUTIES, ISSUES

# AND EXAMPLES

# Introduction.

# A. Fiduciaries have certain responsibilities, including

1. Acting solely in the interest of plan participants and their beneficiaries

2. Carrying out their duties prudently

3. Following the plan documents, unless they are inconsistent with ERISA

4. Diversifying plan investments

5. Paying only reasonable plan expenses

# B. Fiduciary status is based on the functions performed for a plan, not just a person’s title. A plan must name at least one fiduciary. The fiduciaries will frequently include the trustee, investment advisers, all those who exercise discretion in administration of the plan. The key is whether an individual or entity is exercising discretion or control over the plan.

C. The key to complying with fiduciary requirements is to act prudently. This means that if the fiduciary is required to make a decision in an area in which the fiduciary does not have expertise, the fiduciary hires someone with professional knowledge in that area. Prudence focuses on the process for making fiduciary decisions. Therefore, it is advisable to document decisions and the basis for decisions.

# Duty to act in the best interests of all participants. *Moench* revisited. A pension plan fiduciary has a duty to act in the best interests of all plan participants. This duty applies to the manner in which the fiduciary invests plan assets. A fiduciary can be responsible for choosing inappropriate investments. Generally, it is considered a violation of fiduciary duties to concentrate plan investments in company stock in favor of a more diversified portfolio.

## *Moench v. Robertson*, 62 F.3d 553 (3rd Cir. 1995)

### ERISA exempts ESOP fiduciaries from duty to diversify investments

### *Moench* – bank sponsored ESOP

### Bank under federal regulatory review – Board aware of significant problems

### Board members served as ESOP investment committee

### Stock lost all of its value – shareholders sued, ESOP did not join

### Holding – ESOP investment fiduciary presumed to act consistently with ERISA

## B. Several circuits have adopted *Moench* presumption

C. Recent cases:

1. *In Re: Citigroup ERISA Litigation*, 662 F.3d 128 (2nd Cir. Oct. 19, 2011)

a. Adopted *Moench* presumption that fiduciary presumed to act prudently

b. Unless overcome by dire circumstances objectively foreseeable

c. Fiduciary does not have a duty to provide nonpublic information regarding future performance

2. *Pfeil v. State Street Bank and Trust Co.*, 671 F.3d 585 (6th Cir. 2012)

a. Participants in GM 401(k) Plan allege breach of fiduciary duty by continuing to offer GM stock as an investment option

b. Court held that *Moench* presumption not apply at pleading stage

c. Rebut presumption by showing a prudent fiduciary in similar circumstances would have made a different decision

II. Duty to educate participants – authority of the SPD. A pension plan fiduciary has a duty to educate plan participants on the provisions of their plan. This includes a duty to provide participants with a Summary Plan Description. In recent years, plan participants have brought actions based on discrepancies between an SPD and the associated plan document. The Supreme Court recently issued an opinion addressing whether the terms of an SPD could establish plan participant rights. *CIGNA v. Amara*, 131 S.Ct. 1866 (2011)

1. CIGNA amended pension plan, provided information to Participants including a revised SPD
2. SPD was incomplete and misleading, thereby violating ERISA
3. District Ct presumed “likely harm” from misrepresentations and ordered CIGNA to reform Plan to match SPD
4. Supreme Ct. agreed that providing SPD is a fiduciary function
5. It held that ERISA authorizes claims to enforce provisions of the Plan, not the SPD
6. SPD cannot be read to amend the Plan
7. Issuance of intentionally misleading SPD might qualify for relief under ERISA “other equitable relief” provision
8. *Del Rosario v. King & Prince Seafood corp.*, 2011 U.S. App LEXIS 13204 (11th Cir. June 28, 2011)
   1. Allegation that Plan Administrator did not property explain distribution rights in notices
   2. Court affirmed lower court dismissal of claims under ERISA sec. 502(a)(1)(B) because plaintiffs due not additional benefits under Plan
   3. Case remanded for review in light of *Amara* for breach of fiduciary duty under equitable surcharge theory
   4. April 4, 2012, Court approved a $2.875 million settlement

III. Valuation date for determining benefits. The date to be used to value a participant’s account for purposes of benefit distribution is an important issue for plan administrators. This is a particularly important issue in times of rapid stock value fluctuation and can have a significant impact on an ESOP due to the reliance on company stock.

1. *Wakamatsu v. Dentists/Plan*, No. C 11-00482 CR (D.C. N.D. Calif. 4/9/2012)
   1. Ex-employee claimed 401(k) benefit 2 weeks before 2008 year end, based on her 2007 year end account value
   2. Administrator determined that would be detrimental to other participants and delay payment to 2009 based on 2008 year end account value. Reduction in benefit of about $35,736.
   3. Court held that the Administrator acted reasonably and fulfilled duties to all plan participants by refusing to apply 2007 valuation
2. *McCabe v. Capital Mercury Apparel*, 752 F.Supp.2nd 396 (SD.N.Y. 1/9/2010)
   1. ESOP company liquidating assets and winding down
   2. Directed ESOP distributions to vested terminated participants with accounts of less than $1,000 based on most recent valuation. Most recent valuation was $0.015/share as of June 20, 2008.
   3. Paid out on June 1, 2009.
   4. Share value on June 30, 2009 - $0.13
   5. Court held distribution using June 30, 2008 value proper under the plan terms and that ERISA fiduciary had duty to follow plan terms unless contrary to ERISA)

IV. Ensuring that an ESOP does not overpay for company stock. One of an ESOP fiduciary’s duties is to pay no more than fair market value for company stock. If the stock received by the ESOP in exchange for its payment does not constitute “adequate consideration”, the transaction is a prohibited transaction subject to sanction. Therefore, the manner of determining the purchase price for ESOP transactions is extremely important.

1. *Kenny Christopher, as Trustee of Embroidery Library, Inc. ESOP v. Harlan L. Hanson*, 2011 U.S. Dist. Lexis 60201 (D. Minn. June 6, 2011)
   1. ESOP trustee alleged former corporate board members and former ESOP trustee breached duties by inflating stock price in sales to ESOP and forcing company to enter into burdensome restrictive covenants
   2. Mr. Hanson and his family owned 70% of corporate stock, he also was the ESOP trustee at time of transactions
   3. No independent trustee for either transactions
   4. Appraiser valued company at $15.2 million
   5. Allegedly, appraiser not told that in 2004 an investment banking firm trying to market the company at that time only received offers up to $4.4 million and valuation at that time came in at $5.6 million
   6. In spring 2006, Mr. Hanson allegedly told Company president that she would be fired if he was not able to sell the remainder of his stock to the ESOP in December for $275 per share
   7. Defendants resigned seats on Board on December 31, 2006, second transaction completed later that same day
   8. Defendants sought summary judgment and made several arguments including that they were not fiduciaries at time of transaction, no violation of fiduciary duty occurred and there was “adequate consideration”
   9. Court denied all but one summary judgment claim
   10. It found sufficient evidence of breach of duty of loyalty and prudence, failure to follow corporate counsel’s advice that ESOP should have independent counsel, failure to provide appraiser with information on efforts to sell company and that share prices were too high
2. *Bacon v. Stiefel Laboratories, Inc.*, 677 F.Supp. 2d 1331 (S.D. Fl. 2010)
   1. Company terminated stock bonus plan – offered participants option to put shares to company for $16.459 per share
   2. Company confidentially engaged in merger talks at that time.
   3. Merger closed with a price of $68.515 per share
   4. Court denied defendant’s motion to dismiss finding that a reasonable participant would have wanted to know of merger discussions

V. Potential conflicts of interest when ESOP is majority shareholder. Special challenges can arise when an ESOP becomes the majority shareholder of a company. Frequently, in those situations, key employees are members of the corporate board and are plan trustees. When that happens, conflicts of interest, or the appearance of conflicts of interest can arise. When the ESOP is the majority shareholder, the ESOP can have responsibility for company operational problems.

A. *Johnson v. Couturier*, 572 F.3d 1067 (9th Cir. 2009)

1. ESOP participants challenged President’s executive compensation package

2. ESOP was sole corporate shareholder

3. President was sole ESOP Trustee

4. He was also one of two members of the board

5 Court found corporate directors were subject to ERISA fiduciary duties for business decisions resulting in excessive compensation

B. *Jimenez v. Mayfield Lumber and Container Corporation*, 2012 WL 176185 (W.D. Tex. Jan. 20, 2012)

1. Complaint alleged that Mayfield was ESOP administrator, but did not allege bad acts by Mayfield

2. Instead, it alleged bad acts such as opting out of a lease, entering into a $3 million loan and self-dealing by a high ranking employee

3. Court dismissed the case on the basis that the plaintiff failed to sue a plan fiduciary

4. Court also found that alleged misconduct was related to corporate, not fiduciary, acts

VI. Participant’s rights to company information. Is a company, or a ESOP, required to provide a valuation report to participants? - *Boyajian v. California Products Corp,* 2011 US. Dis. LEXIS 110912 (D.Mass. Sept. 28, 2011)

1. Court found ERISA does not require disclosure of valuation report to participants because it is not a document under which the plan is established or operated
2. A few other courts have reached similar decisions

VII. Proposed DOL regulation on definition of a fiduciary. A plan fiduciary is subject to fiduciary duties which include acting in the best interests of plan participants. Participants can bring actions against a fiduciary for alleged violations of fiduciary duties. The Department of Labor has proposed regulations that would clarify, and potentially expand, who is a fiduciary.

1. Fiduciary status applies to a person who exercises discretionary authority or control over
   1. Management of the plan
   2. Plan assets or
   3. Renders investment advice
2. DOL concerns
   1. Participants need protection from conflicts of inters and self-dealing
   2. Incorrect valuations of employer securities are a common problem
   3. DOL does not have enforcement power against non-fiduciaries
3. Proposed regulation specifically included appraisals and fairness opinions, which is a reversal of DOL’s current position
4. Proposed regulation generated significant comment from ESOP professionals
5. Late last year, the DOL announced it would withdraw the proposed regulation
6. DOL intends to issue a new proposal in 2012
   1. Will coordinate with SEC and Commodity Futures Trading Commission
   2. Ensure that new regulation is consistent with other agencies’ regulation of investment professionals and fiduciary conduct

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