Directors' Liability for Corporate Mismanagement of 401(k) Plans: Achieving the Goals of ERISA in Effectuating Retirement Security

Kimberly Lynn Weiss*

Introduction

Enron employees, who lost most of their retirement savings when Enron stock plummeted from $80 to .40 cents per share,[1] unfortunately are not alone. The recent explosion in 401(k) class action litigation has produced several corporate defendants who are similarly situated to Enron, including Global Crossing, WorldCom, Williams Cos., Rite-Aid, Lucent, Xerox, EDS, Duke Power, Qwest, McKesson, Bristol Myers, AOL Time Warner, Providian Financial,[2] IPALCO,[3] and Kmart.[4] Lenette Crumpler, a fifty-one-year-old single mother from Rochester, New York, lost everything in her 401(k) account—$86,000—when Global Crossing stock collapsed early in 2002.[5] Marjorie Young, an employee at Indianapolis Power & Light Company (IPALCO) lost the $200,000 that she had saved in her thirty-seven years at IPALCO after it merged with AES Corporation and the shares fell by nearly ninety-seven percent.[6] The eighty-two year-old IPALCO mailroom worker could not even afford to replace the windows in her drafty old house.[7] At the same time that IPALCO employees lost $95.4 million in their 401(k) plans in 2001, fourteen key officers and directors sold more than $22 million of their company stock just months before the stock price dramatically fell. As the officers and directors were selling their stock, they were simultaneously urging plan

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* J.D. Candidate, 2005, Indiana University School of Law—Indianapolis; B.A., 2002, Indiana University—South Bend, South Bend, Indiana.

1. Rob Norton, *What if Your Company's 401(k) Plan Lays an Egg?*, CORPORATE BOARD MEMBER, Nov.-Dec. 2003, *available at* http://www.boardmember.com/issues/archive.pl?article_id=11727.

2. Evan Miller, *Current Issues in Employee Benefits Litigation*, 697 PLI/LIT 825, 828 (2003).

3. Chris O'Malley, *Stock Sale: IPALCO Chiefs Defend Selling Stock Shares Before Merger*, INDIANAPOLIS STAR, Dec. 1, 2002, at A01.

4. Gary Haber, *Former Kmart Executives Want Judge to Drop Suit over the Retailer's Finances*, DETROIT FREE PRESS, July 1, 2003, *available at* 2003 WL 56852233.

5. Jeff Manning, *The 401(k) Problem*, PORTLAND OREGONIAN, Dec. 1, 2002, at E01, *available at* 2002 WL 3985590. However, companies do not have to fail for employees to lose their retirement savings in 401(k) plans that are heavily invested in employer company stock. Lucent Technologies, Qwest Communications International, and Tyco International, for example, avoided bankruptcy, while employees still lost a majority of their retirement savings when the company's stock dramatically fell. *Id.*

6. O'Malley, *supra* note 3, at A01.

7. *Id.*

participants and beneficiaries to hold IPALCO stock to exchange for AES shares.[8] Sadly, Crumpler's and Young's stories are not atypical, and thousands of other employees have found themselves in similar positions.

The Employee Retirement Income Security Act of 1974 ("ERISA"),[9] the federal statute covering 401(k) plans,[10] was established to protect the benefits of employees, such as the those at Global Crossing and IPALCO. ERISA is meant to protect those employees from abuse by employers, or those acting on the employer's behalf, by regulating fiduciaries' conduct and making them personally liable for breaches of fiduciary duty.[11] This Note focuses on the ERISA fiduciary duties owed by directors to employees as a result of directors' involvement in the management and administration of 401(k) plans. Under ERISA, in addition to officers and plan committee members, directors have a fiduciary duty to manage the investment process of their company's 401(k) plan prudently and solely in the interest of the plan participants.[12] In order to avoid liability for the mismanagement of plan assets, directors must be aware of what their fiduciary obligations entail. Unfortunately, neither ERISA nor the courts have clearly outlined director's fiduciary duties with regard to 401(k) plans. Therefore, a portion of this Note is devoted to outlining situations where directors have been found in violation of their fiduciary duties, thus providing directors with a better understanding of their responsibilities. By understanding their responsibilities, directors can help prevent plan losses in the first instance, thereby shielding themselves from liability.

As litigation over 401(k) plan losses increases in the future, it is even more crucial that directors understand their fiduciary obligations under ERISA. The number of fiduciary lawsuits against directors in companies offering a 401(k) plan will likely increase for several reasons: (1) the increased use of such plans by employers as retirement security,[13] (2) the lack of diversification and heavy

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8. *Id.*

9. 29 U.S.C. §§ 1001-1169 (2000).

10. ERISA is the primary body of federal law that provides for the protection of employee benefit rights. Martha L. Hutzelman, *Fiduciary Liability of Employers Sponsoring Pension Plans*, SH020 ALI-ABA 307, 309 (2002).

11. Jerald I. Ancel, *Counsel for Debtors Beware!*, AM. BANKR. INST. J., July-Aug. 2001, at 8 (2001).

12. Martin v. Harline, 15 Employee Benefits Cas. 1138, No. 87-NC-115J, 1992 U.S. Dist. LEXIS 8778, at *26-34 (D.C. Utah Mar. 30, 1992).

13. Companies are increasingly moving from guaranteed pension plans, which are in the category of defined benefit plans, to uninsured employee-managed 401(k) plans, which are in the category of defined contribution plans. O'Malley, *supra* note 3, at A01; *see also* EMPLOYEE BENEFITS SEC. ADMIN., U.S. DEP'T OF LABOR, DOES 401(K) INTRODUCTION AFFECT DEFINED BENEFIT PLANS? (n.d.), *available at* http://www.dol.gov/ebsa/publications/papkepensionreport.html (last visited Apr. 17, 2005). Defined contribution plans have increasingly become popular among employers, and from 1979 to 1998 they have more than doubled from 331,432 to 673,626, as reported by the Congressional Research Service in July 2002. In the same years, the number of defined benefit plans declined from 139,489 to 56,405. Manning, *supra* note 5, at E01. Currently,

investment in employer stock options for 401(k) plans,[14] (3) the recent economic downturn, and (4) the high media exposure of recent accounting scandals negatively affecting 401(k) plans.[15] Consequently, given that a fiduciary who breaches his ERISA duties is *personally* liable to make good any losses to the plan resulting from his breach of fiduciary duty[16] and given that the average cost of merely defending a fiduciary claim was estimated to be $124,000 in 2000,[17] directors must take extra precautions to help ensure that they do not become subject to such lawsuits in the future.

Unfortunately, too many directors underestimate their role as fiduciaries in 401(k) plans. Although many directors do not realize this, ERISA's fiduciary

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forty-seven million Americans are saving for retirement in 401(k) plans. Penelope Wang, *Is Your 401(k) Safe? What the Fund Scandal Means for Your Retirement?*, MONEY, Jan. 1, 2004, at 72, *available at* 2004 WL 55037553. The definitions of defined benefit plans and defined contribution and their distinctions are further outlined in Part I of this Note. *See infra* Part I.

14. ERISA does not forbid investment of 401(k) plan assets in employer securities. Susan J. Stabile, *Pension Plan Investments in Employer Securities: More Is Not Always Better*, 15 YALE J. ON REG. 61, 64 (1998). In fact, in 401(k) plans, employees may invest up to 100% of their assets in employer securities if the plan document allows, as well as hold a substantial percentage of an employer's outstanding securities. *Id.* at 68. For example, in January 2001, Enron employees had approximately sixty percent of 401(k) funds invest in company stock, a third of which was company matched with restrictions on diversification. *The Enron Collapse and Its Implications for Worker Retirement Security: Hearings Before the House Comm. on Education and the Workforce*, 107th Cong. 112 (2002) (statement of Mikie Rath, Benefits Manager, Enron Corporation), *available at* http://benefitslink.com/articles/enronretirementsecurityhearing20020207.pdf. In 1996, according to Access Research Inc., a financial services consulting firm, nearly a quarter of the $675 billion in 401(k) plans was invested in employer securities. Ellen E. Schultz, *Frittered Away: Some Workers Find Retirement Nest Eggs Full of Strange Assets*, WALL ST. J., JUNE 5, 1996, at A1, *available at* 1996 WL-WSJ 3105461.

15. Jeffrey D. Mamorsky & Terry L. Moore, Greenberg Traurig LLP, *Fiduciary Audit Insurance: Risk Management for Post-Enron ERISA Compliance*, GT ALERT, June 2002, at 2, *available at* http://www.gtlaw.com/pub/alerts/2002/mamorskyj_06a.asp; *see also supra* notes 1-5. Merely examining Enron's 401(k) plan losses alone, which were about $1.3 billion, illustrates the seriousness attributable to the recent 401(k) scandals. Manning, *supra* note 5, at E01.

16. 29 U.S.C. § 1109(a) (2000).

17. *ERISA Suits Spark Liability Concerns*, FIN. EXECUTIVE, June 1, 2004, at 57, *available at* 2004 WLNR 14766919. In addition to defense costs, the average indemnity payment per claim in 2000 was $1.2 million, up from $900,000 in 1999. *Id.* Although in larger corporations, directors are sometimes protected against personal liability through their company's indemnity or through fiduciary liability insurance, *id.*, protection often is limited to a certain dollar amount. *See infra* notes 20-23. And even if directors are wholly protected against personal liability, they nonetheless have a significant interest in avoiding such lawsuits, which can be devastating to their corporation's finances, reputation, and overall well-being, in addition to time-consuming and embarrassing for the directors, who may be displaced from the company as a result of their negligence and/or misconduct.

obligations are among the "highest known to the law."[18] For example, although the directors and officers in Enron were not directly involved in the management or administration of Enron's defined contribution plans, they are still subject to liability under ERISA for any breach resulting from their discretionary control over the plan investments.[19] If Enron's directors lose this legal battle, they will be subject to personal liability in an amount that will almost assuredly exceed the eighty-five million dollars they have in fiduciary liability insurance coverage given the fact that plan losses exceed one billion dollars.[20] In fact, eighteen former Enron directors have already agreed to pay $168 million to settle a lawsuit brought by investors for alleging not adequately overseeing the company.[21] Ten directors will be contributing $13 million of their own money, thereby agreeing to personal payouts to shareholders.[22] The Enron settlement followed the WorldCom settlement where directors named in a class-action shareholder lawsuit for similar allegations agreed to pay $18 million of their own money.[23]Accordingly, for obvious reasons, directors must educate themselves about the numerous ways they can be subject to liability under ERISA and take the necessary precautionary measures to avoid liability by careful planning, management, and oversight.

Currently, the liability of corporate directors surrounding mismanagement of 401(k) plans is anything but clear. However, with the increase in high-profile cases, the set of legal precedents produced as a result of these cases will likely better define company obligations to employees, providing directors with a much better roadmap to follow when dealing with 401(k) plans. In light of the recent events, it is expected that courts will more vigorously scrutinize directors' ERISA fiduciary duties, holding the board accountable for their involvement, even if their involvement is limited to appointment of plan administrators (those who actually manage the plan assets).

However, before the courts take drastic measures to hold board members

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18. *See* Bussian v. RJR Nabisco, Inc., 223 F.3d 286, 294 (5th Cir. 2000).

19. John D. Hughes & Jason M. Rodriguez, *Securities and ERISA Suits—A Fatal Combination*, *in* NATIONAL UNDERWRITER PROPERTY & CASUALTY-RISK & BENEFITS MANAGEMENT, Nov. 21, 2003, *available at* 2003 WL 69821726. The plaintiffs alleged that Enron directors and officers breached their fiduciary duties by failing to adequately monitor and oversee plan administrators, by issuing deceptive public statements about the company's financial condition, and by encouraging employees to continue to invest in company stock when the directors and officers knew or should have known that such an investment was imprudent. *Id.*

20. Jeff Manning, *401(k) Lawsuits Might Aid Reform*, CHI. TRIB., Dec. 31, 2002, at 5, *available at* 2002 WL 104502170; Jim Hopkins, *Firms May Boost 401(k) Insurance*, USA TODAY, Jan. 28, 2002, *available at* http://www.usatoday.com/money/energy/2002-01-29-enron-insurance.htm; *see also* Lawrence, *infra* note 216.

21. Matt Krantz & Greg Farrell, *Ex-Enron Officials OK $168M Payment*, USATODAY.COM, Jan. 10, 2005, *available at* http://www.usatoday.com/money/industries/energy/2005-01-10-enron-usat_x.htm.

22. *Id.*

23. *Id.*

personally liable for plan losses, they should take a step back and analyze the cases in light of the competing congressional purposes and public policy interests behind ERISA. There is obviously a very strong public interest in maintaining the security of America's retirement system, as evidenced by congressional intent in the establishment of ERISA.[24] The court in *Hollingshead v. Burford Equipment Co.*[25] outlined this congressional intent: "[T]his statute was passed with the overwhelming purpose of protecting the legitimate expectations harbored by millions of employees of a measure of retirement security at the end of many years of dedicated service."[26] However, equally important in protecting retirement security, the courts must not make the burdens so tenuous on employers that they no longer have an incentive to provide 401(k) plans,[27] a phenomenon that has already occurred with defined benefit plans.[28]

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24. As retirement plans rapidly began to increase in the 1970s, Congress, noting the rapid growth in such plans, set out to "assur[e] the equitable character of [employee benefit plans] and their financial soundness." Cent. States, Southeast & Southwest Areas Pension Fund v. Cent. Transport, Inc., 472 U.S. 559, 570 (1985) (quoting ERISA statute) (alterations in original); ERISA of 1974, Pub. L. No. 93-406, § 2, 88 Stat. 829, 829 (outlining the goal of ERISA as to promote retirement security).

25. 747 F. Supp. 1421 (M.D. Ala. 1990).

26. *Id.* at 1443 (quoting Rettig v. Pension Benefit Guar. Corp., 744 F.2d 133, 155 (D.C. Cir. 1984)).

27. Employers are not required to establish employee benefit plans; rather, such plans are completely voluntary. However, if an employer chooses to offer the plans, it must abide by ERISA. *See In re* WorldCom, Inc., 263 F. Supp. 2d 745, 757 (S.D.N.Y. 2003). The decline of 401(k) plans would create disastrous results for the American people with respect to their retirement security. For many investors, 401(k) plans, or other types of defined contribution plans, make up their entire financial retirement plan outside of their home equity. Wang, *supra* note 13, at 72. In fact, according to the Federal Reserve, $2.2 trillion was invested in the defined contribution system in 1998. *401(k) Day an Occasion for 55 Million Americans to Celebrate*, PSCA.ORG, June 17, 1999, *at* http://www.psca.org/press/p1999/june17.html.

28. The reason that defined benefit plans (guaranteed pension plans) have taken a back seat to defined contribution plans (401(k) plans) is because ERISA placed too high administrative and regulatory costs on defined benefit plans. *See supra* text accompanying note 13; Susan J. Stabile, *The Behavior of Defined Contribution Plan Participants*, 77 N.Y.U. L. REV. 71, 85 (2002); *see generally* Eugene P. Schulstad, Note, *ERISA Disclosure Decisions: A Pyrrhic Victory for Disclosure Advocates*, 34 IND. L. REV. 501 (2001). When ERISA was enacted in 1974, 401(k) plans did not exist. The retirement plans offered by employers were guaranteed pension plans, Lorraine Schmall, *Defined Contribution Plans After Enron*, 41 BRANDEIS L.J. 891, 899 (2003), and Congress's intent with ERISA was to increase the overall number of retirement plans and the number of employees entitled to receive employee retirement benefits. However, instead "the combined burdens placed on employers by the passage of ERISA and subsequent court decisions have caused considerable tension between the needs of businesses and the desires of [guaranteed pension] plan participants." Schulstad, *supra*, at 501. Thus, in light of the recent upsurge in 401(k) litigation, courts must be careful not to follow the same pattern with directors' liability for 401(k) plans.

The court in *Varity Corp. v. Howe*,[29] recognized these competing interests:

> [C]ourts may have to take account of competing congressional purposes [when interpreting ERISA fiduciary duties], such as Congress' desire to offer employees enhanced protection for their benefits . . . and . . . its desire not to create a system that is so complex that administrative costs, or litigation expenses, unduly discourage employers from offering welfare benefit plans in the first place.[30]

Essentially, Americans will only realize the protections underlying ERISA if the interests of plan participants and directors/employers can be adequately balanced so that the ultimate goal of ERISA enforcement is realized—to provide retirement security.

Although courts need to provide the necessary incentives for directors to effectively carry out their obligations as ERISA fiduciaries with regard to 401(k) plans, they must not do so in a way that places too heavy a burden on directors. Thus, the courts should hold directors liable only for mismanagement of plan assets for which they could have prevented through careful review of plan investment decisions, particularly the procedures followed in determining plan options. This is not a standard where directors are required to reevaluate decisions made by competent plan administrators, but rather, a standard where directors are required to review and oversee investment decisions, keeping their eyes open for possible breaches of fiduciary duties, such as conflicts of interests. In effect, directors should only be found liable if they were on notice of fiduciary violations, or would have been on notice had they been properly carrying out their duties of oversight. Holding directors liable for abuses of plan assets that they could have prevented only by exacting investigation will place too high administrative and litigation costs upon companies. However, it is equally important to provide incentives for directors to correctly manage 401(k) plan assets so that employees are left with adequate retirement security. Therefore, courts should strictly enforce ERISA obligations by holding directors personally liable for plan losses if they fail to adequately monitor plan assets by careful review.

Part I of this Note provides a basic understanding of 401(k) plans. Part II provides a general understanding of the fiduciary duties under ERISA and how fiduciary status is determined. Part III specifically outlines the general fiduciary status of a director and further outlines the various situations in which a director is likely to be held liable with respect to 401(k) losses. The particular situations outlined in Part III include: exercising de facto control over investment options, appointing and monitoring responsibilities, and misrepresenting or omitting information regarding 401(k) investments. Part IV offers advice for directors to reduce their potential liability by complying with 404(c) regulations, various other procedures, and obtaining fiduciary liability insurance. Finally, the Note concludes by analyzing the potential conflict between the competing interests of

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29. 516 U.S. 489 (1996).

30. *Id.* at 497.

imposing ERISA fiduciary obligations on directors and ensuring that employers continue to establish and offer 401(k) plans.

I. Brief Introduction to Understanding 401(k) Plans

Two broad categories of retirement plans which ERISA recognizes are defined benefit plans and defined contribution plans.[31] Unlike defined benefit plans, defined contribution plans are not guaranteed[32] and instead shift investment risks squarely onto the shoulders of participants, regardless of their investing know-how.[33] The most common type of defined contribution plan is a 401(k) plan, which allows employees to put a part of their salaries into a retirement account that is tax-deductible.[34] Under such plans, the employees' earnings are only taxed when the employee retires or otherwise withdraws money from the account.[35] Employers can choose to contribute to the account, which they often do by using employer stock as the matching contribution.[36] These plans allow employees to direct the investment of their account balances by choosing among the investment options offered by the employer.[37] Thus, in a defined contribution plan, employees are not promised a specified pension benefit, but rather, benefits are determined by the value of the investment when the employee takes money out of the plan.

Another popular type of defined contribution plan that is very similar to a 401(k) plan and which often is used in conjunction with a 401(k) plan, is the employer stock ownership plan (ESOP).[38] An ESOP is an individual account

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31. Stabile, *supra* note 14, at 66 (ERISA recognizes these two broad categories within 29 U.S.C. § 1002(34)-(35) (2000)).

32. Under a defined benefit plan, a company promises and guarantees cash pension benefits after the employee works a specified amount of time based on a pre-determined formula. 29 U.S.C. § 1002(35) (2000). Pension plans are also federally guaranteed by the Pension Benefit Guarantee Corporation (PBGC). Schmall, *supra* note 28, at 901. Because the employer is managing the funds and determining how it is invested, the breadth of legal obligations under such plans are significantly greater. *Id.* at 897.

33. Manning, *supra* note 20, at 5. Other types of defined contribution plans include: 401(a), 403(b), 457, KEOGH, Simplified Employee Pension (SEP), Individual Retirement Account (IRA), and SIMPLE Plan. For further information on the above plans, see Northwestern Mutual Financial Network, *Types of Defined Contribution Plans*, *at* http://www.nmfn.com/tn/learnctr--articles--page_types_defn_cont (last revised Dec. 2003).

34. Schmall, *supra* note 28, at 894. 401(k) plans were first introduced in a 1978 amendment to the Internal Revenue code (IRC) § 401(k) in order to allow employees to put a portion of their earnings away for retirement and to allow employers to make contributions, without having to pay taxes on the savings. *Id.* at 899. The law did not go into effect until January 1, 1980. *Id.* at 900.

35. *Id.* at 894.

36. *Id.*

37. Stabile, *supra* note 14, at 66.

38. *Id.*

pension plan that is designed to invest primarily in employer securities.[39] An employer who establishes an ESOP contributes either stock or cash to the plan, which is then used by the ESOP trustee to purchase shares.[40] Many companies will combine an ESOP with a 401(k) plan using stock contributions to match the 401(k),[41] and, consequently, fiduciary obligations of both 401(k) plans and ESOPs are often similarly analyzed, as illustrated within the text of this Note.[42]

II. Brief Introduction to Understanding ERISA

A. General Fiduciary Duties Under ERISA

Under ERISA, a fiduciary is one who owes duties to the plan participants and beneficiaries, and thus, must exercise care, skill, prudence, and diligence in fulfilling those duties.[43] The fiduciary obligations under ERISA are similar to that of a trustee of a trust or an executor of an estate,[44] except that the legislative history and case law indicate that the ERISA standard is intended to be more stringent.[45] An ERISA fiduciary owes both a duty of loyalty and a duty of care to the plan and must discharge his duties with respect to the plan solely in the interest of the participants and beneficiaries.[46] Accordingly, a fiduciary under a plan is prohibited from dealing with the assets of a plan in his own interest or for his own account.[47] Furthermore, a fiduciary with respect to a plan shall not "in his individual or in any other capacity act in any transaction involving the plan on behalf of a party (or represent a party) whose interests are adverse to the interest of the plan or the interests of its participants."[48]

The fiduciary must also act "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims."[49] This standard is not of a "prudent lay

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39. *See* I.R.C. § 409(a)(2) (2004).

40. Stabile, *supra* note 14, at 66.

41. The National Center for Employee Ownership, *401(k) Plans and ESOPs* (2002), *at* http://www.nceo.org/library/401k.html (last visited Apr. 17, 2005).

42. *See In re* Ikon Office Solutions Sec. Litig., 191 F.R.D. 457, 462 n.5 (E.D. Pa. 2000) (suggesting that courts will examine fiduciary duties under a 401(k) plan in the same way as an ESOP plan); *see also infra* note 124.

43. 29 U.S.C. § 1104(a)(1)(A) (2000).

44. Ancel, *supra* note 11, at 8.

45. *See* Donovan v. Mazzola, 716 F.2d 1226, 1231 (9th Cir. 1983); *see also* Stabile, *supra* note 14, at 71.

46. 29 U.S.C. § 1104(a)(1).

47. *Id.* § 1106(b)(1).

48. 29 U.S.C. § 1106(b)(2).

49. *Id.* § 1104(a)(1)(B). This latter duty applies to the overall management of the plan and its assets. The central fiduciary duties found in ERISA section 404 are as follows:

> [A] fiduciary shall discharge his duties with respect to a plan solely in the interests of

person" but rather of a "prudent fiduciary with experience" and thus, if the fiduciary does not have the knowledge and expertise needed to make a prudent decision, he has a duty to obtain independent advice.[50] This is an objective standard focusing on the conduct of the particular fiduciary and consequently "a pure heart and an empty head are not enough."[51] The test for prudence focuses on whether the fiduciaries, at the time they engage in a transaction, have "employed the appropriate methods to investigate the merits of the investment and to structure the investment."[52] Thus, whether or not the investment was prudent in hindsight is not what counts; rather, the question is whether the investment was prudent at the time it was made.

The duties under ERISA also apply to inaction taken by a fiduciary who is aware of, or should be aware of, another person's breach. The fiduciary will be liable if he (1) knowingly conceals the breach, (2) fails to act prudently and in the interests of the plan participants and beneficiaries in carrying out his own duties, thereby enabling the other fiduciary to breach his duty, or (3) discovers the breach, but fails to exercise reasonable efforts to remedy it.[53] Although courts have generally required that fiduciaries follow adequate procedures for investigating decisions affecting the plan by examining the conduct by the person who made the decision, they are not necessarily required to reevaluate the merits themselves.[54]

> the participants and beneficiaries and
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> (A) for the exclusive purpose of:
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> (i) providing benefits to participants and their beneficiaries; and
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> (ii) defraying reasonable expenses of administering the plan;
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> (B) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character and with like aims;
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> (C) by diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and
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> (D) in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of this subchapter. . . .

Id. § 1104(a)(1)(A)-(D); *but see id.* § 1104(a)(2) (providing that "in the case of an eligible individual account plan, . . . the diversification requirement of paragraph (1)(C) and the prudence requirement (only to the extent that it requires diversification) of paragraph (1)(B) is not violated by the acquisition and holding of . . . qualifying employer securities").

50. Howard v. Shay, 100 F.3d 1484, 1490 (9th Cir. 1996).

51. *See* Keach v. U.S. Trust Co., 240 F. Supp. 2d 840, 845 (C.D. Ill. 2002) (quoting Donovan v. Cunningham, 716 F.2d 1455, 1467 (5th Cir. 1983)).

52. Donovan v. Mazzola, 716 F.2d 1226, 1232 (9th Cir. 1983).

53. 29 U.S.C. § 1105(a).

54. *See* H.R. REP. NO. 93-533, at 312-12 (1974), *reprinted in* 1974 U.S.C.C.A.N. 4639, 4650-51; *Cunningham*, 716 F.2d at 1467; *Mazzola*, 716 F.2d at 1232-33; Arakelian v. Nat'l W. Life

If a fiduciary breaches his duty under ERISA, he is personally and individually liable to make good to the plan any losses resulting from his breach of fiduciary duty.[55] Co-fiduciaries who have knowledge of, knowingly participate in, or enable the commitment of a breach of duty by another fiduciary are jointly and severally liable with the breaching fiduciary.[56] In addition to financial liability, the court can award a full range of equitable remedies to the plaintiffs to correct past abuses and to deter future misconduct.[57]

B. Determining Fiduciary Status Under ERISA

The first issue that must be addressed in any ERISA lawsuit is whether or not the defendants are acting as fiduciaries under the plan.[58] A person can become a fiduciary under ERISA in three ways: (1) being named as the fiduciary in the instrument establishing the plan;[59] (2) being named as a fiduciary pursuant to a procedure specified in the plan instrument, e.g., being appointed an investment manager who has fiduciary duties toward the plan;[60] or (3) falling under the statutory definition of fiduciary.[61] A person is a fiduciary under the statutory definition to the extent:

> (i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets, (ii) he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or (iii) he has any discretionary authority or discretionary responsibility in the administration of such

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Ins. Co., 680 F. Supp. 400, 405-06 (D.D.C. 1987).

55. 29 U.S.C. § 1109(a).

56. *Id.* § 1105(a).

57. *Id.* § 1132(a)(5). Furthermore, courts have held that these remedies are not precluded by other federal statutes. For example, there may be instances when ERISA claims and securities-fraud claims, which are governed by the Private Securities Litigation Reform Act (PSLRA), overlap. In *Vivien v. Worldcom, Inc.*, No. C 02-01329 WHA, 2002 WL 31640557 (N.D. Cal. July 26, 2002), the court held that it could not dismiss an ERISA claim simply because recovery under ERISA overlaps with recovery under PSLRA. The conflict between ERISA and federal securities law is further discussed in Part III.B.3, *infra*.

58. Hull v. Policy Mgmt. Sys. Corp., No. CIV.A.3:00-778-17, 2001 WL 1836286, at *4 (D.S.C. Feb. 9, 2001).

59. 29 U.S.C. § 1102(a); *see also* Glaziers & Glassworkers Union Local No. 252 Annuity Fund v. Newbridge Sec., Inc., 93 F.3d 1171, 1179 (3rd Cir. 1996); Keach v. U.S. Trust Co., 240 F. Supp. 2d 840, 843 (C.D. Ill. 2002).

60. 29 U.S.C. § 1102(a)(2); *see also Glaziers & Glassworkers*, 93 F.3d at 1179; *Keach*, 240 F. Supp. 2d at 843.

61. 29 U.S.C. § 1002(21)(A); *see also Glaziers & Glassworkers*, 93 F.3d at 1179; *Keach*, 240 F. Supp. 2d at 843.

plan.[62]

Consequently, under the above definitions, an individual may be a fiduciary with respect to some of his actions, but not others, and therefore will only be subject to liability for those portions of a plan over which he exercises discretion or control.[63]

Effectively, a fiduciary is either someone who is designated as a fiduciary or administrator ("named fiduciary") either directly under the plan document or by way of a procedure outlined in the plan, such as through appointment,[64] or someone who undertakes a fiduciary function, but who has not been named in the plan document or appointed to carry out that function ("functional fiduciaries").[65] Fiduciary status is fairly straight forward when someone is a named fiduciary, for example, when dealing with a plan administrator.[66] As defined by ERISA, the term "administrator" is the person designated by the terms of the plan document, and if no administrator is named, then the administrator is the person acting as the plan sponsor, such as the employer.[67] The ERISA plan administrator is always a fiduciary, and thus can be made personally liable for plan losses to the extent that he has authority to act, and either acts negligently or fails to act when doing so would be prudent.[68] Furthermore, the plan documents can also designate persons as fiduciaries for specific purposes.[69] For example, a plan committee member can be designated for the purpose of overseeing investment strategies and thus will have fiduciary obligations with respect to those responsibilities.[70]

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62. 29 U.S.C. § 1002(21)(A).

63. *Hull*, 2001 WL 1836286, at *4 (addressing only the issue of whether the defendants breached their fiduciary duties with respect to the portions of the plan for which they exercised discretionary control); *see* Crowley *ex rel.* Corning, Inc. Inv. Plan v. Corning, Inc., 234 F. Supp. 2d 222, 229 (W.D.N.Y. 2002); Schultz v. Texaco, Inc., 127 F. Supp. 2d 443, 451-52 (S.D.N.Y. 2001).

64. A "named fiduciary" is one "who is named in the plan instrument, or who, pursuant to a procedure specified in the plan, is identified as a fiduciary . . . by a person who is an employer or employee organization," by an employer and employee organization acting jointly with respect to the plan. 29 U.S.C. § 1102(a)(2).

65. Fred Reish & Joe Faucher, *Who Are the Investment Fiduciaries for a 401(k) Plan? (Part 1)*, J. PENSION BENEFITS, Autumn 2000, *available at* http://www.reish.com/publications/article_detail.cfm?ARTICLEID=272.

66. Fred Reish & Debra Davis, Reish Luftman Reicher & Cohen, *The DOL's Enron Brief: What It Means for 401(k) Investments*, Apr. 2003, *at* http://www.reish.com/publications/article_detail.cfm?ARTICLEID=393.

67. 29 U.S.C. § 1002(16)(A).

68. C. Frederick Reish & Joseph C. Faucher, Reish Luftman Reicher & Cohen, *What's in a Name?—Director and Officer Liability Under ERISA*, July 1998, *at* http://www.reish.com/publications/article_detail.cfm?ARTICLEID=39.

69. *Id.*

70. *Id.*

III. ERISA as It Applies to Directors' Involvement with 401(k) Plans

A. General Fiduciary Status of a Director

ERISA expressly contemplates that an officer, employee, or other representative of a company may serve as a fiduciary of a plan.[71] In a typical situation, the board of directors (or the employer, if not a corporation) will establish an ERISA plan and is therefore the initial fiduciary.[72] In some cases the employer, board members, or officers retain some or all the management and administrative duties outlined in the plan document, in which case they will have fiduciary duties with respect to those responsibilities.[73] Directors who are named fiduciaries under the plan document, or are appointed by procedures in the plan, should be aware that they have fiduciary duties and should be on notice as to what those fiduciary duties entail. For example, in *In re McKesson HBOC, Inc. ERISA Litigation*,[74] the court found that because the plan document provided that the Compensation Committee had responsibility for determining the investment policy of the plan, and since the Committee was comprised of the Board of Directors, all directors were proper defendants for breach of fiduciary duty claims involving 401(k) plan losses.[75]

Nevertheless, the more typical, but more complex, situation is where a director is not a named fiduciary, but rather a functional fiduciary.[76] Unfortunately, liability regarding breach of fiduciary liability by a functional fiduciary is more ambiguous than that of a named fiduciary since such a determination is based on actual authority or power demonstrated instead of formal title and duties.[77] Usually, as functional fiduciaries, directors appoint individuals or committees to be responsible for choosing investment options and managing and administering the plan,[78] and are not themselves responsible for the

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71. 29 U.S.C. § 1108(c)(3).

72. *Fiduciary Responsibility for 401(k) Plans*, BENEFIT INSIGHTS, June 2002, *at* http://www.jdb401k.com/bulletins/bi2002_06.htm.

73. *Id.*

74. No. C00-20030, 2002 WL 31431588 (N.D. Cal. Sept. 30, 2002).

75. *Id.* at *10.

76. *See* Rankin v. Rots, 278 F. Supp. 2d 853, 871 (E.D. Mich. 2003) (holding that the defendants' argument that they were not fiduciaries because they were not named as the Plan Administrator "misses the mark." Since the complaint alleged that the directors exercised discretionary authority with respect to the Plan, if proven, the directors would be ERISA fiduciaries); *see also* Reish & Faucher, *supra* note 65.

This Note focuses primarily on director functional fiduciary roles within a corporation, not only because this is the more typical situation when discussing director liability for mismanagement of 401(k) plans, but also because fiduciary status of a functional fiduciary is not as clearly defined and causes more confusion.

77. *See In re* Enron Corp. Sec., Derivative & "ERISA" Litig., 284 F. Supp. 2d 511, 659-60 (S.D. Tex. 2003).

78. *See id.* (according to the relevant terms of the Savings Plan, Enron had exercised the

selection of the 401(k) investments.[79] Those appointed will then become named fiduciaries under the plan and, like all named fiduciaries, must perform their duties under the "prudent expert" standard.[80]

In situations where the board appoints committee members to manage and administer the plan, the board members will be fiduciaries to the extent that they retain any discretionary authority or control over the plan.[81] With regard to fiduciary duties of the board of directors, the Department of Labor (DOL), the government agency charged with interpreting and enforcing the provisions of Title I of ERISA,[82] stated:

> Members of the board of directors of an employer which maintains an employee benefit plan[83] will be fiduciaries only to the extent that they have responsibility for the functions described in section 3(21)(A) of the Act [ERISA]. For example, *the board of directors may be responsible for the selection and retention of plan fiduciaries. In such a case, members of the board of directors exercise 'discretionary authority or discretionary control respecting management of such plan' and are, therefore, fiduciaries with respect to the plan.* However, their responsibility, and, consequently, their liability, is limited to the selection and retention of fiduciaries (apart from co-fiduciary liability . . .).[84]

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power of appointment, which, as a corporation, it necessarily did through its Board of Directors). The Savings Plan in *Enron* was a 401(k) plan that permitted participants to "invest their deferrals among an array of investment funds." Marianne W. Culver, *Current Issues in Employee Benefits Litigation*, 697 PRACTICING L. INST. LITIG. & ADMIN. PRAC. COURSE HANDBOOK SERIES: LITIG., 839, 884 (2003). One of these funds was an Enron stock fund. Enron's matching contributions under the plan were made primarily in Enron stock as an ESOP. *Id.* at 884-85.

79. *Fiduciary Responsibility for 401(k) Plans*, *supra* note 72; *see e.g.*, *Enron Corp.*, 284 F. Supp. 2d at 659; Crowley *ex rel.* Corning, Inc. Inv. Plan. v. Corning, Inc., 234 F. Supp. 2d 222, 229 (W.D.N.Y. 2002); Hull v. Policy Mgmt. Sys. Corp., No. CIV. A. 3:00-778-17, 2001 WL 183686, at *6 (D.S.C. Feb. 9, 2001).

80. *Fiduciary Responsibility for 401(k) Plans*, *supra* note 72.

81. *See, e.g.*, Yeseta v. Baima, 837 F.2d 380, 384-85 (9th Cir. 1988); Leigh v. Engle, 727 F.2d 113, 134-35 (7th Cir. 1984); *see also* Fred Reish & Bruce Ashton, Reish Luftman Reicher & Cohen, *Who Are the Investment Fiduciaries for Your Company's 401(k) Plan? (Part II)* (Aug. 2002), *at* http://www.reish.com/publications/article_detail.cfm?ARTICLEID=241.

82. *See* 29 U.S.C. § 1135 (2000); *see also* Plaintiff's Complaint, *Enron Corp.*, 284 F. Supp. 2d 659 (S.D. Tex. 2003) (No. CIV.A.H01-3913) [hereinafter DOL Complaint] (Secretary of DOL's Complaint), *available at* http://www.dol.gov/_sec/media/announcements/lawsuit.pdf. Although the DOL's regulations do not have the force of law, courts should give deference to the DOL's reasonable interpretations. Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 842-45 (1984).

83. According to ERISA, an "'employee benefit plan' or 'plan' means an employee welfare benefit plan or employee pension benefit plan or a plan which is both an employee welfare benefit plan and an employee pension benefit plan." 29 U.S.C.A.; § 1002(3).

84. 29 C.F.R. § 2509.75-8 (2004) (emphasis added); *see also* Landry v. Air Line Pilots Ass'n

The DOL reiterated this stance on directors' fiduciary status in its *Enron* brief opposing the defendants' motions to dismiss, arguing that directors who had the power to appoint, retain, and remove members of the Administrative Committee had discretionary authority over the management or administration of a plan under ERISA, and were therefore fiduciaries with respect to those obligations.[85] The U.S. District Judge Melinda Harmon in Houston agreed with the DOL and denied Enron's motions to dismiss.[86] If the board of directors is given the responsibility to appoint officers or committee members to oversee the administration and investment of the plan, they will not only be obligated to exercise prudence in appointing qualified members, but will also be obligated to "take prudent and reasonable action to determine whether the administrators [are] fulfilling their fiduciary obligations,"[87] by regularly monitoring their performance.[88] However, aside from appointing and monitoring obligations, if the board members act in any other capacity with respect to the plan, such as advising plan participants of various investment options, they will likely be subject to further fiduciary duties with regard to those actions.[89]

The broad definition of fiduciary status found under ERISA provides for various circumstances in which directors are fiduciaries with respect to a 401(k) plan, and thereby subject to the high standard of loyalty and care required of an ERISA fiduciary. Accordingly, it is imperative that directors realize when they are acting in such a position, particularly when acting as functional fiduciaries, so that they can establish procedures and guidelines to protect themselves from potential liability. Although the law is currently unsettled with regard to directors' liability for mismanagement of 401(k) plans, it is likely that with the recent upsurge in high-publicity cases involving employees who have lost their retirement due to corporate scandals, courts will further expand fiduciary status and fiduciary duties under ERISA. In fact, the DOL's heavy-handed brief against Enron's corporate defendants should send a warning signal to board members that any involvement with a 401(k) plan resulting in losses to employees may subject them to liability under ERISA.

Int'l AFL-CIO, 901 F.2d 404, 417 (5th Cir. 1990) (holding that members of the board of directors of an employer that maintains an employee benefit plan will be viewed as fiduciaries for *only* those functions listed in ERISA § 3(21)(A) for which they exercise discretionary control or authority, such as the selection and retention of plan fiduciaries).

85. Amended Brief of the Secretary of Labor as Amicus Curiae Opposing the Motions to Dismiss, at 9-10, *Enron Corp.*, 284 F. Supp. 2d 659 (S.D. Tex. 2003) (No. CIV.A.H-01-3913) [hereinafter Amended Brief of the Secretary of Labor], *available at* WL 32157092.

86. *Enron Corp.*, 284 F. Supp. 2d at 511.

87. Leigh v. Engle, 727 F.2d 113, 135 (7th Cir. 1984).

88. Fred Reish & Gail Reish, *Fiduciary Responsibilities for Managing 401(k) Plans and Their Investments*, THE PENSION ACTUARY, May-June 2001, *available at* http://www.unifiedtrust.com/Fiduciary_Responsibilities_for_Managing_ERISA_Investments. pdf.

89. *See, e.g.*, *Leigh*, 727 F.2d at 136; Arden Dale, *Fund Probe Highlights Shifting Ground for Fiduciaries*, DOW JONES NEWS SERVICE, Nov. 14, 2003.

However, rather than deterring directors from offering 401(k) plans in the future, cases such as *Enron* should provide directors with foresight into potential liability, thereby enabling them to put into place adequate cost-effective procedures that will shield the directors from personal liability, and at the same time, help prevent plan losses in the first instance. The next sections outline various situations in which directors are likely to be held liable with respect to employees' suits arising out of 401(k) losses and possible preventative measures that directors can take to avoid such potential liability.

B. Situations Involving Potential Liability for a Director Acting as a Fiduciary

Informing directors of their potential liability regarding their involvement with 401(k) assets is essential to the financial security of American retirees in two ways: 1) directors will have an incentive to put into place preventative measures to safeguard plan assets, thereby decreasing the likelihood that they will face liability; and 2) by decreasing their potential liability, directors will be more willing to continue to offer 401(k) plans in the future (assuming that the costs for the necessary preventative measures do not outweigh the benefits to employers who voluntarily offer such plans).

1. De Facto Control over Investment Options.—One of the most obvious ways that a director can become subject to liability for mismanagement of plan assets is to exercise de facto control over the plan options. Although the director is not named in the plan to carry out such functions, the court will look beyond the plan's terms to identify who is actually exercising discretionary control, either directly or indirectly, over the management plan assets.[90]

In *Leigh v. Engle*, the court was faced with the issue of de facto control under ERISA concerning two defendants, Libco Corporation and Clyde Engle.[91] Defendant Libco Corporation was a holding company that acquired one hundred percent of the common stock of Reliable Manufacturing and consequently was responsible for appointing the directors of that company. Defendant Engle had a controlling interest in Libco and was a director of Reliable Manufacturing, thus

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90. 29 U.S.C. § 1002(21)(A) (2000) ("[A] person is a fiduciary with respect to a plan to the extent . . . he exercises *any* discretionary authority or discretionary control respecting management of such plan or exercises *any* authority or control respecting management or disposition of its assets . . . .") (emphasis added).

91. *Leigh*, 727 F.2d at 113. The type of retirement plan at issue in *Leigh* was a profit-sharing trust, as opposed to a 401(k) plan. *Id.* at 115. A profit-sharing trust is a plan where the employer uses a portion of the profits of the company in a trust fund for eventual distribution to employees upon some specified events, such as death, disability, termination, or attainment of a specified retirement age. *See* James T. Tilton & Janice R. Moore, *Non-Qualified Deferred Compensation: Postponing Taxation While Securing the Benefit*, 275 PLI/TAX 283, 326-28 (1988). Nevertheless, the same ERISA provisions would apply to a director who exercises de facto control over a 401(k) plan. *See supra* Part I.

responsible for appointing the plan administrators.[92] The district court found that Libco and Engle were not fiduciaries with respect to the investment because plaintiffs failed to show that they exercised direct control over investment options.[93] The court of appeals was more skeptical. Although on paper, Engle's and Libco's authority over the plan could be exercised only indirectly through appointment power, the court found that, "ERISA directs courts to look beyond Engle and Libco's formal authority with respect to the plan, limited to selection and retention of administrators, and to consider what *real authority* they had over plan investments."[94] Through their selection of appointees, Dardick and Zuckerman, Engle and Libco "presumably obtained substantial de facto control over plan investment decisions."[95] Dardick was Engle's personal attorney and general counsel to Engle's various businesses and, consequently, most of Dardick's income came from an entity controlled by Engle. Furthermore, Dardick was assisting Engle and Libco in the acquisition of the three companies for which the plan administrators were investing plan assets.[96]

Zuckerman, on the other hand, was a paid member of the Libco board and an investment consultant to Libco; thus, he was ultimately hired by Engle.[97] He was also the president of Reliable Manufacturing and member of its board, and, therefore, he too had substantial interest in the outcome of the acquisition efforts that was congruent with Engle's and Libco's.[98]

Ultimately, the court of appeals found that the plaintiffs failed to show that the district court clearly erred in finding that the defendants did not exercise authority over the trust's investments, but then proceeded to hold the defendants liable for their involvement in the plan in various other capacities.[99] Nevertheless, this is a situation where the court could have found de facto control by a director, and would have likely done so if the standard was not clearly erroneous and had there not been another avenue to hold Engle liable. This was a situation where Engle appointed plan administrators who he had significant control over and who had similar goals to his own and therefore would effectuate those goals through the administrator's authority to invest plan assets. Directors who put themselves in that position should be on notice that they will likely be subject to fiduciary liability arising out of the mismanagement of plan assets.

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92. *Leigh*, 727 F.2d at 116-17, 135.

93. *Id.* at 135.

94. *Id.* (emphasis added). *But see* Crowley *ex rel.* Corning, Inc. Inv. Plan v. Corning, Inc., 234 F. Supp. 2d 222, 229 (W.D.N.Y. 2002) (finding that the "only power the Board had under the Plan was to appoint, retain, or remove members of the Committee[and t]hus, the Board's fiduciary obligations can extend only as to those acts") (citation omitted).

95. *Leigh*, 727 F.2d at 135.

96. *Id.*

97. *Id.* at 117.

98. *Id.* at 135.

99. Leigh v. Engle, 858 F.2d 361, 364 (7th Cir. 1988); *see infra* text accompany notes 115-16.

A similar situation occurred in *Keach v. U.S. Trust Co.*,[100] but here, the court found, based upon the court's language in *Leigh*, that the directors were exercising de facto control over the plan assets by appointing a specific trustee to effect a stock purchase transaction and therefore had relatively extensive fiduciary duties. Defendant Thomas Foster, chairman of the board of directors, and Defendant Melvyn Regal, vice chairman of the board of directors, were not named fiduciaries of the plan, but they both actively selected U.S. Trust as the trustee for the Plan. Consequently, the court looked beyond the limited duty of selection and retention of the plan administrators to determine if Foster or Regal had actual authority over the plan's investments.[101] The court found that the directors had appointed U.S. Trust as trustee to replace the former trustee "apparently with the sole purpose of effectuating the stock purchase transaction,"[102] as Regal testified in his deposition that there would have been no need to appoint a trustee if the transaction was not going to take place.[103] Accordingly, the court held:

> [T]he selection of U.S. Trust as trustee for the ESOP was so inextricably intertwined with the desired end of effectuating the stock purchase transaction that the act of appointing the trustee essentially exercised *de facto* control over the plans [sic] assets and management. Thus, the particular facts of this case make it readily distinguishable from the cases cited by Foster and Regal, as their actions clearly constituted the "something more" than the mere holding of a corporate office or appointment power found to be insufficient to bestow fiduciary status over the distribution of plan assets in those cases.[104]

The findings in *Leigh* and *Keach* should not be surprising. Under ERISA, if a director is exercising actual control over plan assets, directly or indirectly, he will be held to the high standards of fiduciary duty outlined in ERISA. Directors cannot shield themselves from liability by appointing someone else to do what they want done. As a result, unless directors can meet the fiduciary obligations under ERISA for management and investment of plan assets,[105] they should

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100. 234 F. Supp. 2d 872 (C.D. Ill. 2002). This case did not involve a 401(k), but rather an ESOP. However, like *Leigh*, the court's reasoning with respect to ERISA fiduciary duties would be analogous to 401(k) plan as the ERISA provisions are the same under both plans. *See supra* text accompanying note 42.

101. *Keach*, 234 F. Supp. 2d at 881-82.

102. *Id.* at 882.

103. *Id.*

104. *Id.* at 882-83.

105. *See* ERISA § 404(a), 29 U.S.C. § 1104(a) (2000) *and* ERISA § 406(b), 29 U.S.C. § 1106(b). For example, under ERISA section 406(b)(1), the "selection of a person to manage the investment of plan funds constitutes dealing with plan assets, if such a delegation were made in a manner which operates in a plan fiduciary's own interest or for its own account, the delegation of investment management authority would be . . . prohibited . . . ." *Op. F-3867 A*, 1992 ERISA LEXIS 38, at *10 (Dep't of Labor, Pension & Welfare Benefit Programs, Jan. 17, 1992).

refrain from appointing plan administrators over whom they exercise significant control. Furthermore, when directors place themselves in such a situation, the court should construe their fiduciary obligations strictly so as to ensure that directors will not have an incentive to mismanage plan assets for their own benefit. ERISA was enacted to prevent just this sort of behavior by plan fiduciaries. Therefore, a hard-line approach against directors who knowingly violate their fiduciary obligations at the expense of employees' retirement security will most effectively assure that the goals of ERISA are realized.

To prevent litigation based on the allegation of de facto control, the board members should appoint only independent plan administrators who are free from any conflicts of interest concerning plan investments. The less intertwining the board members have with plan administrators, the less likely they will be subject to liability based upon de facto control, and the more likely plan assets will be properly invested.

2. *Appointing and Monitoring Plan Administrators*.—Typically, the board members, either through the plan documents or simply by way of normal business operations, will have a duty to appoint 401(k) plan fiduciaries and to periodically review their performance.[106] Consequently, a director will likely first be subject to fiduciary duties when deciding who to appoint as plan fiduciaries.[107] In *Martin v. Harline*,[108] the plan document, like many plan documents, gave the board of directors the responsibility of appointing

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106. *See* Reish & Ashton, *supra* note 81.

107. Is it well-settled that the act of appointing plan administrators is a fiduciary function and thereby confers fiduciary status. *See* Liss v. Smith, 991 F. Supp. 278, 310 (S.D.N.Y. 1998). However, in *In re WorldCom, Inc.*, 263 F. Supp. 2d 745, 760 (S.D.N.Y. 2003), the court found that plaintiff's arguments that the directors were ERISA fiduciaries merely because of their power to appoint and remove individuals as plan administrators or investment fiduciaries was going too far. The DOL, in its brief filed on January 19, 2004, opposed the view taken by the court, arguing that ERISA imposes an obligation on those who appoint plan fiduciaries to monitor and oversee their decisions, as they are also fiduciaries under the plan. *See News Briefs: Labor Department Backs Suit Against WorldCom*, PENSIONS & INVESTMENTS, Jan. 26, 2004, at 50, *available at* 2004 WL 65596562. The *Enron* court agreed with the DOL, finding that the power to appoint and remove individuals does confer fiduciary status. The court distinguished *WorldCom* by noting that "WorldCom did not appoint anyone as a fiduciary and there apparently were no allegations that Director Defendants *functioned* as fiduciaries, i.e., actually appointed persons to or removed persons from such positions." *In re* Enron Corp. Sec., Derivative & "ERISA" Litig., 284 F. Supp. 2d 511, 553 n.59 (S.D. Tex. 2003) (emphasis in original).

Consequently, when a director is given the role of appointment, either under the plan or through his position in the company, he becomes a fiduciary under the plan and must discharge those duties in a prudent manner. *See* ERISA § 404(a), 29 U.S.C. § 1104(a).

108. 15 Employee Benefits Cas. 1138, No. 87-NC-115J, 1992 U.S. Dist. LEXIS 8778 (D. Utah Mar. 30, 1992). The Plan document in this case was an ESOP; however, the analysis with regard to fiduciary obligations under ERISA for appointment of plan fiduciaries will be analogous to 401(k) plans. *See supra* text accompanying note 42.

fiduciaries to carry out the management of the plan assets.[109] In fulfilling this obligation, the board members have a duty to prudently appoint qualified plan fiduciaries. If directors appoint unqualified plan fiduciaries

> who are untutored and inexperienced in the operations of [the Plan] and the investment of its assets [they] owe a special duty to the Plan to ensure that the appointed fiduciary clearly understands his obligations, that he has at his disposal the appropriate tools to perform his duties with integrity and competence, and that he is appropriately using those tools.[110]

To avoid a special duty and increased potential liability for appointing untutored and inexperienced plan participants, directors should appoint experienced committee members who are skilled in investing and who can prudently select a team of advisors to assist in devising investment alternatives.[111]

Furthermore, directors' duties do not end after appointment of plan committee members. Directors are also subject to ERISA fiduciary obligations to the extent that they have responsibility for oversight or retention of plan administrators.[112] Since ERISA recognizes that a person may be subject to fiduciary obligations for some purposes and not others, directors can be liable for failure to monitor and oversee plan committee members, even if they are not found liable with respect to the administrators' investment decisions.[113] Thus,

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109. *Harline*, 1992 U.S. Dist. Lexis 8778 at *3.

110. *Id.* at *29. The duty to use reasonable care in selecting and instructing a qualified person to delegate responsibility for plan assets is analogous to that of a trustee. *Id.* at *29-30.

111. Reish & Faucher, *supra* note 65.

112. *See* Martin v. Schwab, 15 Employee Benefits Cas. 2135, No. CIV.A.91-5059-CVSW-1, 1992 WL 296531, at *4 (W.D. Mo. Aug. 11, 1992); *see also In re* Elec. Data Sys. Corp., "ERISA" Litig., 303 F. Supp. 2d 658, 671 (E.D. Tex. 2004) (finding that ERISA law imposes a duty on fiduciaries with appointment power to monitor appointees); Rankin v. Rots, 278 F. Supp. 2d 853, 871 (E.D. Mich. 2003) (stating that the directors delegated discretionary authority with respect to the plan and therefore had a duty to monitor the decision of those to whom authority had been delegated).

113. Leigh v. Engle, 727 F.2d 113, 134-35 (7th Cir. 1984) (holding that Engle and Libco had a duty to appropriately monitor the administrators' actions). The duty to properly monitor and oversee plan fiduciaries can be found in ERISA sections 404 and 405(a). Under ERISA section 404(a), 29 U.S.C. § 1104(a), a fiduciary is required to discharge his fiduciary duties with care, skill, prudence, and diligence. Under ERISA section 405(a), 29 U.S.C. § 1105(a), a fiduciary is responsible for his co-fiduciaries' breaches:

> (1) if he participates knowingly in . . . an act or omission of such other fiduciary . . .;
> (2) if, by his failure to comply with section 404(a)(1) . . . in the administration of his specific responsibilities which give rise to his status as a fiduciary, he has enabled such other fiduciary to commit a breach; or
> (3) if he has knowledge of a breach by such other fiduciary, unless he makes reasonable efforts under the circumstances to remedy the breach.

Some courts have distinguished section 404(a) from section 405(a) by describing section 405(a) directors cannot abdicate their duties by merely giving over the day-to-day operations of the plan investments to even qualified appointees. Rather, directors have a continuing duty to "act with an appropriate prudence and reasonableness in overseeing" the plan administrators' management of the plan.[114] In *Leigh*, the

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more specifically as "co-fiduciary liability," where a fiduciary has knowledge of another fiduciaries' breach, but fails to do anything to correct it. However, when analyzing directors' duties after appointment, section 405(a) is essentially a failure of oversight responsibility—allowing another fiduciary to breach his duties without taking any corrective actions. It makes little sense to analyze section 404(a) and section 405(a) differently, since section 405(a) includes breaches under section 404(a). Nevertheless, some courts require more to show co-fiduciary liability, such as actual knowledge. *See* Keach v. U.S. Trust Co., 240 F. Supp. 2d 840, 844 (C.D. Ill. 2002) (finding that co-fiduciary liability under section 405(a) requires "actual knowledge" of the breach); *see also* Donovan v. Cunningham, 716 F.2d 1455, 1475 (5th Cir. 1983) (for same proposition).

Consequently, any fiduciary who becomes aware that a co-fiduciary has breached his fiduciary duty may not avoid liability by simply ignoring the breach and hiding his head in the sand. *See* Jackson v. Truck Drivers' Union Local 42 Health & Welfare Fund, 933 F. Supp. 1124, 1141 (D. Mass. 1996). In its brief in opposition to the motions to dismiss in *Enron*, the DOL argued that even if the "[c]ourt were to find that [certain defendants] were not liable under § 404 . . . the Court could find these defendants liable under § 405 . . ., if their actions enabled other fiduciaries to breach their duties." Amended Brief of the Secretary of Labor, *supra* note 85, at 14. A fiduciary who breaches section 405 is jointly and severally liable with the breaching fiduciary. ERISA section 405(a), 29 U.S.C. § 1105(a) (2000).

114. *Leigh*, 727 F.2d at 135; *see also* Newton v. Van Otterloo, 756 F. Supp. 1121, 1132 (N.D. Ind. 1991) (finding that the power to appoint and remove plan fiduciaries makes board members fiduciaries, thus requiring adherence to the standards of ERISA section 404, and additionally entails the duty to appropriately monitor the administrators' actions). However, in *Crowley ex rel. Corning, Inc. Investment Plan v. Corning, Inc.*, 234 F. Supp. 2d 222 (W.D.N.Y. 2002), the court did not place any significance on the directors' duty of oversight and retention of plan fiduciaries, and instead focused on the directors' duties outlined in the plan document. *Corning*, 234 F. Supp. 2d at 222. The complaint in *Corning* alleged that defendants had breached their fiduciary duties by continuing to offer company stock as an investment alternative, by over-allocating company stock in the plan, and by making material misrepresentations and failing to disclose crucial information regarding the stock; thereby causing losses to the plan. *Id.* at 227. The court found that the board of directors held fiduciary duties only with respect to those powers specifically defined under the plan document, which consisted of appointing, retaining, or removing members of the Committee. *Id.* at 229. Nevertheless, the court found that since plaintiffs made no allegation that the directors breached any fiduciary duty when it *appointed* members of the Committee, and since, under the plan, the directors were not responsible for investment options or management of plan assets, the complaint failed to state a claim against the directors. *Id.* at 229-30. It appears that the court in *Crowley* did not recognize directors' duty to monitor after appointment. Arguably, however, this omission may have been a result of plaintiff's failure to state a claim with respect to monitoring and oversight responsibilities. The court is unclear regarding this issue. *See also* Hull v. Policy Mgmt. Sys. Corp., No. CIV.A.3:00-778-17, 2001 WL 1836286, at *7 (D.S.C. Feb. 9, 2001) ("Assuming the Board's right to remove Committee members might be stretched to include a duty of supervision . . . there are simply no allegations in the complaint adequate to support a

court held that although Engle, the director responsible for appointing and removing the trust administrators, was not obligated to examine every action taken by Dardick and Zuckerman, the plan administrators, in light of their knowledge that the administrators were faced with conflicting loyalties with respect to plan investments, the directors were obligated to take prudent and reasonable action to ensure that the administrators were fulfilling their fiduciary responsibilities.[115] The administrators in *Leigh* breached their fiduciary duties when they made investment decisions based not on the best interests of the plan participants, but out of personal motivations. The trial court found that Engle was aware of the administrators' breach, but failed to do anything to rectify the situation. By not doing so, Engle failed to meet his fiduciary duties under ERISA.[116]

In *Martin v. Harline*, the CBI board of directors was given the responsibility under the Plan Document to "periodically review performance of Fiduciaries to whom any allocation or delegation of duties has been made by the Board of Directors."[117] The directors, including Harline, were placed on notice, or reasonably should have been placed on notice, by several different entities, concerning the imprudent investments being made by the plan administrators, Nuffer and Harris.[118] Particularly, the Federal Reserve Bank of San Francisco sent the CBI Board of Directors a Report of Inspection strongly recommending that the board have qualified external appraisers take independent valuations of company stock and citing a number of possible violations of ERISA in connection with management and administration of the plan.[119] Nevertheless, the board members failed to take the recommended action. The court held that the Board of Directors:

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claim for failure to supervise the Committee."). In any case, the court in *Corning* interpreted the directors' fiduciary responsibilities far more narrowly than did the DOL in its complaint and motion in opposition of dismissal in the Enron litigation, which opposition the *Enron* court later upheld. *See* Roger C. Siske & Michael R. Maryn, *ESOPs: A Case Study*, SJ013 ALI-ABA 519, 559 (2003).

115. *Leigh*, 727 F.2d at 136 (remanding to determine if the directors had violated their fiduciary duty of oversight; however, the court noted that "[n]othing in the record" demonstrated that the corporation's board or its chairman "took steps either to insure that [the plan administrators] were fulfilling their fiduciary obligations or to remedy any violations which might have already occurred"); *see also In re* Unisys Sav. Plan Litig., 74 F.3d 420, 435 (3d Cir. 1996) (finding that fiduciaries do not need to duplicate their advisers' investigative efforts, but they do have a duty to review their advisers' data, to determine its significance, and supplement the information if needed; merely accepting advisers' findings without more, is not sufficient).

116. Leigh v. Engle, 858 F.2d 361, 364 (7th Cir. 1988). Essentially, the court's ruling falls under ERISA section 405(a), 29 U.S.C. § 1105(a), by finding that the corporation and its chairman knew of, yet chose to ignore, improper investment decisions.

117. Martin v. Harline, 15 Employee Benefits Cas. 1138, No. 87-NC-115J, 1992 U.S. Dist. LEXIS 8778, at *3 (D.C. Utah Mar. 30, 1992).

118. *Id.* at *17-23.

119. *Id.* at *20-23.

> [I]mprudently permitted Nuffer and Harris to continue to purchase shares of CBI with Plan assets when they knew or through the exercise of reasonable diligence should have known that the prices paid for the shares acquired were not determined by a qualified contemporaneous valuation and were in excess of the fair market value of such shares; and imprudently failed to remove Nuffer or take the appropriate steps to prevent Nuffer from continuing to violate ERISA . . . .[120]

Additionally the court found that permitting Harris to supervise the Plan fiduciaries was imprudent under ERISA section 404(a)(1)(B),[121] 29 U.S.C. § 1104(a)(1)(B), given the deteriorating condition of the company and the participation by Harris in insider transactions involving the Plan.[122] Under these circumstances, the directors violated their duty to appropriately monitor and review the plan fiduciaries and, therefore, the directors were subject to personal liability for the plan losses.[123]

DOL took a similar stance in their complaint against Enron's board of directors and officers, Lay and Skilling, who were responsible for appointing, monitoring, and removing the members of the Plan Administrative Committee. The DOL argued:

> As Enron's stock lost nearly all of its value during 2001, the Plans' fiduciaries never considered the prudence of the Plans' investment in Enron stock or took any action to protect the value of the participants' retirement accounts.[124] As a result of the fiduciaries' total and complete

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120. *Id.* at *27.

121. *See* text accompanying *supra* note 49.

122. *Harline*, 1992 U.S. Dist. LEXIS 8778, at *31.

123. The court additionally found that director Harline breached his fiduciary duty under ERISA section 405, 29 U.S.C. § 1105, with regard to the actions of Harris and Nuffer, since he had actual or constructive knowledge of the facts constituting their breaches of fiduciary duty and failed to take reasonable steps to remedy such breaches. *Id.* at *32; *see also* text accompanying *supra* note 113. The fact that Harline was one of several defendants that could have taken action to remedy the breach did not absolve Harline of responsibility because liability for breaching fiduciary duty is joint and several—"there is no safety in numbers." *Harline*, 1992 U.S. Dist. LEXIS 8778, at *32 n.1.

124. Enron had three plans: the Enron Corp. Savings Plan, the Enron Corp. Employee Stock Ownership Plan (ESOP), and the Cash Balance Plan. *See* Amended Brief of the Secretary of Labor, *supra* note 85. As the DOL in *Enron* analyzed all three plans under the same ERISA fiduciary duties with regard to the specific functions delegated to the various actors within each plan, so too did the court. In *In re Enron Corp. Securities, Derivative & "ERISA" Litigation*, 284 F. Supp. 2d 511, 660-61 (S.D. Tex. 2003), the court analyzed the employee savings plan and the ESOP congruently finding that the allegations that the employer, management committees, officers, and directors had power to appoint, retain, and remove ERISA plan fiduciaries; that they exercised discretionary authority of appointment over management or administration of plans, and that they failed to insure that selected fiduciaries complied with their fiduciary duties, were sufficient

inaction, the Plans lost much of their value and thousands of participants were left with uncertain futures.[125]

Essentially, the DOL asserted that although Lay and Skilling were not named fiduciaries relative to the Plans, they were Plan fiduciaries because they exercised authority over the selection of Administrative Committee members.[126] However, according to the DOL, Lay and Skilling breached their fiduciary duties imposed by ERISA because they failed to monitor the Committee's performance, failed to provide the Committee with adverse knowledge about Enron's true financial condition, of which they were aware, and actively misled participants about Enron's financial condition despite knowledge of its deteriorating condition.[127] Although the board of directors possessed both public and nonpublic information that should have put them on notice that the plan fiduciaries, who they appointed, were not acting with prudence with regard to plan assets, they failed to take any action to correct the fiduciaries breach of both the duty of loyalty and duty of care.[128]

Although directors are not obligated to reinvestigate the merits of the plan committee's decisions, they should establish procedures for conduct and create a system of reporting and supervision to facilitate monitoring by the board of directors.[129] Directors who have responsibility for appointment are required to review the performance of the plan appointees at reasonable intervals "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, and satisfies the needs of the plan."[130] However, if the terms of the plan are such that following them would not be in the best interest of the participants, an investment fiduciary

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evidence to support a claim for breach of fiduciary duties of loyalty and prudence under ERISA. The Savings Plan, which was a 401(k), permitted the participants to direct that their employee contributions be invested in one or more of several investment alternatives, one of which included Enron Stock. Amended Brief of the Secretary of Labor, *supra* note 85, at 34. Furthermore, as noted in *supra* note 42, ESOPs are often analyzed congruently with 401(k) plans, as they are typically part of the same plan.

125. DOL Complaint, *supra* note 82, at 4.

126. As asserted earlier, board members commonly appoint plan administrators, and consequently they would be "functional" fiduciaries with respect to the plan.

127. DOL Complaint, *supra* note 82, at 26. See the next section for further discussion on misrepresentations or omissions by directors regarding 401(k) plans.

128. DOL Complaint, *supra* note 82, at 29.

129. Martin v. Hairline, 15 Employee Benefits Cas. 1138, No. 87-NC-115J, 1992 U.S. Dist. LEXIS 8778, at *30 (D.C. Utah Mar. 30, 1992). Where appointing fiduciaries do not establish a procedure to monitor the performance of the plan's appointed trustees, they have violated their duty of prudence and loyalty under ERISA section 404(a)(1)(A), 29 U.S.C. § 1104(a)(1)(A) (2000). *See* Sandoval v. Simmons, 622 F. Supp. 1174, 1215-16 (C.D. Ill. 1985).

130. 29 C.F.R. § 2509.75-8 (2005); *see also* Henry v. Frontier Indus., Inc., Nos. 87-3879 and 87-3898, 1988 WL 132577, at *3 (9th Cir. Dec. 1, 1988) (unpublished table decision).

must disregard the plan.[131] Because the appointing directors not only have a duty to monitor the fiduciaries' actions, but also have a duty to monitor the investment of the plan assets,[132] this may entail going outside the terms of the plan if doing so would be prudent. If the directors discover that the appointees have taken inappropriate action and have not adequately protected the interests of the plans' participants and beneficiaries, then the directors have a subsequent duty to take remedial measures, including possible removal of appointees or perhaps even withdrawing the plain's investments.[133]

Leigh, Enron, and *Harline* all illustrate the importance of procedural diligence for directors when appointing plan fiduciaries. The first step is to find qualified appointees who are equipped with the skills and tools to effectively manage the plan assets. Subsequently, it is equally important that the directors continue to monitor and oversee the appointed plan fiduciaries to ensure that they remain qualified to manage the plan investments. While this admittedly places a burden on directors to effectuate and maintain procedures to ensure effective management of 401(k) plans, this burden is necessary to maintain employee retirement plans, specifically 401(k) plans. This burden faced by directors is likely to continue its ascent as public opinion increasingly shifts in disfavor of large corporations in light of the recent scandals by corporate defendants for mismanagement of 401(k) plans. For example, in *Enron*, the DOL argued for much broad er fiduciary duties to be placed on directors for their involvement with 401(k) plans, and, consequently, directors need to be aware of the possibility of facing increased liability.

Fortunately, the courts in such cases as *Leigh* and *Harline* held, and even the DOL in *Enron* argued, that liability should be found only in those situations where the Board should have been on notice that the plan fiduciaries were breaching their duties under ERISA.[134] In the preceding three cases, the board

131. *See* Laborers Nat'l Pension Fund v. N. Trust Quantitative Advisers, Inc., 173 F.3d 313, 322 (5th Cir. 1999); Donovan v. Cunningham, 716 F.2d 1455, 1467 (5th Cir. 1983); *see also* Rankin v. Rots, 278 F. Supp. 2d 853, 878 (E.D. Mich. 2003) ("Contrary to the Outside Directors' implication, a fiduciary is not required to blindly follow the Plan's requirements. Indeed, 'a fiduciary must also act "in accordance with the documents and instruments governing the plan," insofar as those documents are consistent with the provisions of ERISA.'") (quoting Best v. Cyrus, 310 F.3d 932, 935 (6th Cir. 2002)). *But see In re* McKesson HBOC, Inc., 29 Employee Benefit Cas. 1229, 2002 U.S. Dist. LEXIS 19473, at *16-17 (N.D. Cal. Sept. 30, 2002) (finding that the plan required investment in company stock and was therefore presumptively proper for the fiduciaries to follow the plan's direction to do so).

132. *See* Mehling v. N.Y. Life Ins. Co., 163 F. Supp. 2d 502, 509-10 (E.D. Pa. 2001) (finding that implicit in the power to select the Plans' named fiduciaries was the duty to monitor the fiduciaries' actions, including their investment of plan assets).

133. *See* Liss v. Smith, 991 F. Supp. 278, 311 (S.D.N.Y. 1998); *see also* Whitfield v. Cohen, 682 F. Supp. 188, 197 (S.D.N.Y. 1988) (recognizing that monitoring fiduciary had a duty to remove plan assets from investment once it became clear, or should have become clear, that investment was no longer proper for the Plan).

134. Several courts recognizing the duty to monitor have given the duty a limited scope,

members simply failed to observe the information that was immediately obvious. When it became apparent that plan assets were being invested imprudently, the directors had a responsibility to take appropriate investigatory steps with regard to the plan fiduciaries' decision-making. The balance struck by the courts in *Leigh* and *Harline* and the DOL in *Enron* is one that recognizes the goal of maintaining effective retirement plans by creating liability for directors only when they could have prevented loss to the plan by simple oversight and monitoring procedures, such as taking action once they were put on notice of imprudent behavior.[135] This does not require the board to constantly scrutinize the actions of the plan fiduciaries, but it does require them to periodically evaluate the plan investments to determine whether the fiduciaries are using appropriate methods for choosing investment alternatives. As a result, directors will be dissuaded from failing to correct mismanagement of 401(k) plans which they can reasonably detect, but will not be dissuaded from offering 401(k) plans as a result of overly burdensome oversight responsibilities.

3. Misrepresentations or Omissions by Directors Regarding 401(k) Plan Assets.—This section concerns directors' misrepresentations and omissions regarding 401(k) plan assets as an extension of the duty to monitor. In fact, the expansive nature of the DOL's argument in *Enron* is based primarily upon the directors' failure to properly communicate investment information to plan participants.[136] Therefore, it is highly prudent for directors to recognize the increasingly expansive nature of fiduciary duties with respect to misrepresentations and omissions.

The rise of litigation over ERISA fiduciary duties with regard to 401(k) plans has often originated with a common complaint—that the plan fiduciaries, including company directors, made misrepresentations or breached their duty to disclose material information that directly affected the value of employee 401(k) plans.[137] Typically, the allegations are based on either misrepresentations that employer stock is a good investment, leading employees to invest more heavily in the company stock, dissuading them from pulling out of the stock, or failure to disclose information about the company which the plan fiduciaries know will influence the employees' decisions regarding how much to invest in company stock, if at all.[138]

The leading Supreme Court case recognizing individual relief for claims

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including the three cases outlined in this Section. *See also* Coyne & Delany Co. v. Selman, 98 F.3d 1457, 1466 n.10 (4th Cir. 1996) ("Courts have properly taken a restrictive view of the scope of this duty and its attendant potential for liability.").

135. *See also* Newton v. Van Otterloo, 756 F. Supp. 1121, 1132 (N.D. Ind. 1991) (finding that directors have duties to monitor plan fiduciaries whom they appoint but do not breach such duties in the absence of "notice of possible misadventure by their appointees").

136. *See infra* notes 149-54 and accompanying text.

137. Proceedings, *Employee Stock Ownership After Enron: Proceedings of the 2003 Annual Meeting, Association of American Law Schools Section on Employee Benefits,* 7 EMPLOYEE RTS. & EMP. POL'Y J. 213, 221 (2003).

138. *Id.* at 222.

based on breach of fiduciary duty by misleading plan participants is *Varity Corp. v. Howe*.[139] In that case, the district court found that the company intentionally misled employees when it told them that their benefits would remain the same if they voluntarily transferred their employment to a separately incorporated subsidiary.[140] This case is an extreme example of material misrepresentations. The firm persuaded employees to transfer their stock into a subsidiary company when the firm knew all along that the subsidiary was in serious financial trouble. The company did so by repeatedly and publicly assuring the employees of the plans' integrity. Consequently, the Supreme Court found that the employer/plan administrator was acting in its fiduciary capacity when it communicated this information to plan participants because reasonable employees would have thought that the employer was communicating with them both in its capacity as employer and as plan administrator and because of the context in which the statements about benefits were made.[141] Since the employer was acting in its fiduciary capacity when it misled employees, it violated ERISA fiduciary obligations.[142] The Court held:

> ERISA requires a "fiduciary" to "discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries." To participate knowingly and significantly in deceiving a plan's beneficiaries in order to save the employer money at the beneficiaries' expense is not to act "solely in the interest of the participants and beneficiaries." As other courts have held, "lying is inconsistent with the duty of loyalty owed by all fiduciaries and codified in section 404(a)(1) of ERISA."[143]

The Court in *Varity Corp.* specifically held that Varity did *not* act as a fiduciary simply because it made statements about its expected financial conditions or that an ordinary business decision had a negative effect on the plan. Rather, Varity Corp. was found liable because it intentionally connected its statement to the future benefits of the plan.[144] Accordingly, *Varity Corp.* established that misrepresentations relating to non-pension benefit plans can establish fiduciary liability for those acting within their fiduciary capacity.[145] Because ERISA

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139. 516 U.S. 489 (1996).

140. *Id.* at 498.

141. *Id.* at 503.

142. *Id.* at 506.

143. *Id.* (citations omitted); *see e.g.*, Pocchia v. NYNEX Corp., 81 F.3d 275, 278 (2d Cir. 1996) (holding that it is "well-settled that plan fiduciaries may not affirmatively mislead plan participants about changes, effective or under consideration, to employee pension benefit plans"); Fischer v. Phila. Elec. Co., 994 F.2d 130, 135 (3d Cir. 1993) ("[W]hen a plan administrator speaks, it must speak truthfully."); Berlin v. Mich. Bell Tel. Co., 858 F.2d 1154, 1163 (6th Cir. 1988) (finding that a duty of loyalty includes an obligation not to materially mislead plan participants and beneficiaries).

144. *Varity Corp.*, 516 U.S. at 505.

145. Previously, the Court in *Massachusetts Mutual Life Insurance Co. v. Russell*, 473 U.S.

defines fiduciary status "functionally," this can make virtually any employee, including directors, subject to the duty not to mislead. Unfortunately, however, the Court decided not to reach the issue of whether fiduciaries have any fiduciary duty to disclose truthful information on their own initiative.[146]

Some courts have subsequently held that fiduciaries not only have an affirmative duty not to mislead, but the duty of loyalty imposed by ERISA also creates a duty to disclose information when silence or inaction is materially misleading.[147] This duty will likely arise in situations where the omission is

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134, 140-43 (1985), held that ERISA section 502(a)(2), 29 U.S.C. § 1132(a)(2), did not provide a remedy for individual beneficiaries in situations similar to that in *Varity Corp.* Section 502(a)(2) states that a civil action may be brought by a participant, beneficiary, or fiduciary for appropriate relief under ERISA section 409, § 29 U.S.C. 1109. ERISA § 502(a)(2), 29 U.S.C. § 1132(a)(2) (2000). Section 1109 (a) states:

> Any person who is a fiduciary with respect to a plan who breaches any of the responsibilities, obligations, or duties imposed upon fiduciaries by this subchapter shall be personally liable to make good to such plan any losses to the plan resulting from each such breach . . . and shall be subject to such other equitable or remedial relief as the court may deem appropriate, including removal of such fiduciary.

29 U.S.C. § 1109. Consequently, *Russell* found that ERISA section 409 plainly authorizes relief only for the plan itself, not individual participants or beneficiaries. *Russell*, 473 U.S. at 144.

The Court in *Varity Corp.*, recognizing the limitation for damages found in section 409, granted individual relief for the misrepresentations based on ERISA section 502(a)(3), 29 U.S.C. § 1132 (a)(3). *Varity Corp.*, 516 U.S. at 509-12. Section 502(a)(3) states that a civil action may be brought in two circumstances:

> [B]y a participant, beneficiary, or fiduciary (A) to enjoin any act or practice which violates any provision of this subchapter or the terms of the plan, or (B) to obtain other appropriate equitable relief (i) to redress such violations or (ii) to enforce any provisions of this subchapter or the terms of the plan.

29 U.S.C. § 1132(a)(3). *Varity Corp.* held that this clause operated as a "catchall" provision to provide for individual relief for breaches of fiduciary duty, but is invoked only in the limited instances in which other provisions of ERISA do not provide relief. *Varity Corp.*, 516 U.S. at 509-12. Additionally, section 502(a)(3) is limited to equitable relief. *Id.* The Court in *Mertens v. Hewitt Associates*, 508 U.S. 248, 256 (1993), previously defined equitable relief as forms typically available in equity, such as injunction, restitution, and the like. Subsequently, the Court in *Great-West Life & Annuity Insurance Co. v. Knudson*, 534 U.S. 204 (2002), in a 5-4 decision, dramatically limited the equitable relief available under section 502(a)(3). *Knudson*, 534 U.S. at 210-11. In *Knudson,* the plaintiff wanted to impose personal liability upon a beneficiary to make restitution to the plan, arguing that the defendant was in breach of his contractual obligations under the plan's reimbursement provision. This provision required the defendant to pay the plan a certain amount of proceeds recovered from third parties. The Court rejected plaintiff's claim, finding that an injunction to compel the payment of money past due under a contract, or specific performance of a past due monetary obligation, was not typically available in equity, as required by ERISA section 502(a)(3). *Id.*

146. *Varity Corp.*, 516 U.S. at 506.

147. *See, e.g.*, Estate of Becker v. Eastman Kodak Co., 120 F.3d 5, 9-10 (2d Cir. 1997)

highly prejudicial to the plan participant, and may also be limited to the director disclosing such information to the plan administrator.[148] For example, the DOL urged the court to take this stance in its brief opposing the motion to dismiss of Enron, Enron plan Committee members, Enron officers, and Enron directors. The DOL advocated that the defendants, including director Lay,[149] had a duty, in light of their knowledge, to provide accurate information regarding Enron's financial condition to the Plan Administrators.[150] The DOL provided the following facts in their motion:

> 57. On October 8, 2001, the Board of Directors was generally informed of the existence of Watkins' memorandum and the concerns it raised.[[151]]
> 58. The import of Watkins' memorandum was clear, or should have been clear, to Lay, Olson[,] and the Board of Directors. Yet, instead of taking action to protect the Plans from the harm of which Watkins had warned, Lay and Olson[[152]] responded to Watkins' memorandum by transferring Watkins to a position in Enron's Human Resources Department and by denying her further access to Enron's financial information.
> 59. Neither Enron, Lay[,] Olson[,] nor the Board of Directors informed the rest of the Plans' fiduciaries of Watkins' concerns or predictions nor did any of these fiduciaries ensure that an independent inquiry

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(holding that a summary plan description and benefits counselor's advice amounted to materially misleading information and therefore breached fiduciary duty to provide participants with complete and accurate information); Glaziers & Glassworkers Local 252 v. Newbridge Sec. Inc., 93 F.3d 1171, 1180 (3d Cir. 1996) (finding that the duty to inform is "not only a negative duty not to misinform, but also an affirmative duty to inform when the trustee knows that silence might be harmful"); Anweiler v. Am. Elec. Power Serv. Corp., 3 F.3d 986, 991 (7th Cir. 1993) (finding an affirmative duty to communicate facts concerning employee rights whether or not a beneficiary asks the fiduciaries for the information). *But see* Bins v. Exxon Co., 220 F.3d 1042, 1045 (9th Cir. 2000) (rejecting "affirmative duty" standard with regard to representations).

148. As the directors are often the appointing body for the administrators, they would have a duty to monitor the administrators' remedial actions after obtaining accurate information regarding plan assets.

149. Directors Lay and Skilling had the responsibility under both the Savings Plan and ESOP to appoint, monitor and remove the members of the Administrative Committee. For a brief description of Savings Plan and ESOP, see *supra* note 78.

150. Amended Brief of the Secretary of Labor, *supra* note 85, at 20.

151. DOL Complaint, *supra* note 82, at 24. On August 14, 2001, Sharon Watkins, Vice-President of Enron at the time, sent out a memorandum to Lay (Skilling quit Enron that day) expressing concern about the accuracy of Enron's publicly reported financial statements. The statement read: "I am incredibly nervous that [Enron] will implode in a wave of accounting scandals. My [eight] years of Enron work history will be worth nothing on my resume." *Id.*

152. Olson was a member of the Plans' Administrative Committee. *Id.* at 22.

was undertaken on behalf of the Plans.[153]

Given these facts, the DOL argued that the fiduciaries not only had a duty to disclose this information to plan fiduciaries, but additionally had a duty not to materially mislead the plan participants by silence or inaction.[154] The DOL asserted that the fiduciaries had violated their duty of loyalty and care under ERISA to carry out the plans for the sole benefit of the participants. The court in *Enron*, agreeing with the DOL and citing to *Varity Corp.*, held that Enron directors may be liable for failure to disclose in special circumstances where there is a potentially "extreme impact" on the ERISA plan as a whole and plan participants generally could be materially and negatively affected.[155] Consequently, in such circumstances, courts might find that the directors have an affirmative duty of disclosure.[156]

When analyzing duty not to mislead and duty to disclose cases, however, a court must also reconcile ERISA fiduciary duties with those required by federal security laws. Although dissemination of information could possibly come into conflict with federal security laws, courts have found that the two laws can be reconciled. In *Enron*, the court noted that securities "laws [do] not immunize [defendants] from a claim that they failed in their conduct as ERISA fiduciaries. To the contrary, while their Securities Act and ERISA duties may conflict in some respects, they are congruent in others."[157] The court acknowledged that there were certain steps that the defendants could have taken to comply with both their duties under ERISA and under securities laws. For example, the directors could have disclosed the information to other shareholders and the public at

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153. *Id.* at 24-25.

154. Amended Brief of the Secretary of Labor, *supra* note 85, at 15.

155. *In re* Enron Corp. Sec., Derivative & "ERISA" Litig., 284 F. Supp. 2d 511, 658 (S.D. Tex. 2003).

156. *Id.*; ERISA § 404 (a)(1), 29 U.S.C. § 1104 (a)(1) (2000). Nevertheless, the court in *Crowley ex rel. Corning, Inc. Investment Plan v. Corning, Inc.*, 234 F. Supp. 2d 222 (W.D.N.Y. 2002), interpreted directors' fiduciary responsibilities of appointment, retention, and removal of plan fiduciaries much more narrowly than did the court in *Enron*. *Crowley*, 234 F. Supp. 2d at 230. In *Crowley*, the court found that plaintiff's claim alleging defendants made material misrepresentations and nondisclosures concerning Corning's future performance failed because the "Board was not charged under the Plan with the duty of communicating information to the Plan participants or beneficiaries." *Id.*; *see also In re* McKesson HBOC, Inc. ERISA Litig., 29 Employee Benefits Cas. 1229, 2002 U.S. Dist. LEXIS 19473, at *52 (N.D. Cal. Sept. 30, 2002) (holding directors not liable for failing to communicate directly with participants where the plan documents did not place such a duty on the directors); Hull v. Policy Mgmt. Sys. Corp., No. CIV.A.3:00-778-17, 2001 WL 1836286, at *7 (D.S.C. Feb. 9, 2001) (finding board member not liable for breach of duty to provide information or duty not to provide false information where the plan does not impose such duties on defendant).

157. *Enron*, 284 F. Supp. 2d at 566. *But see Hull*, 2001 WL 1836286, at *9 (stating in dicta that the defendants did not have a duty to disclose information because to have disclosed nonpublic information would have violated securities laws).

large, because nothing in the securities laws prevented them from doing so or forcing Enron to do so.[158] The court held that the securities laws and ERISA should be "construed to require, as they do, disclosure by Enron officials and plan fiduciaries of Enron's concealed, material financial status to the investing public generally, including plan participants, whether 'impractical' or not, because continued silence and deceit would only encourage the alleged fraud and increase the extent of injury."[159] Otherwise, the directors could have seen to it that the option of Enron stock be eliminated from the plan, because "securities rules do not require an individual never to make any decision based on insider information. To the contrary, the insider trading rules require corporate insiders to refrain from buying (or selling) stock if they have material, nonpublic information about the stock."[160]

Similarly, in *WorldCom*, the court held that Ebbers, a director and officer of the company who had discretionary control over the administration and management of the plan, would have violated his fiduciary duties under ERISA if the following allegations were shown to be true: (1) he failed to disclose to the investment fiduciary on behalf of the plan all material facts he knew or should have known about the financial conditions of WorldCom and (2) he disseminated materially false data and information about WorldCom to plan participants.[161] The court rejected the argument by Ebbers that, as an officer and director, the duties imposed on him as an insider under the federal securities laws necessarily conflicted with the duties imposed by ERISA.[162] The court held, "[w]hen a corporate insider puts on his ERISA hat, he is not assumed to have forgotten adverse information he may have acquired while acting in his corporate capacity."[163] The court was clear that when an ERISA fiduciary discloses false information, no exception exists merely because the disclosure concerns the employer's stock.[164] However, the court limited its ruling, finding that the

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158. *Enron*, 284 F. Supp. 2d at 566. The DOL in its Amicus Brief further noted that corporate insiders owe a fiduciary duty to disclose material nonpublic information to the shareholders and trading public. Amended Brief of the Secretary of Labor, *supra* note 85, at 26 (citing to *In re* Cady, Roberts & Co., 40 S.E.C. 9707, S.E.C. Release No. 34-6668, 1961 WL 60638, at *3 (Nov. 8, 1961) (incorporating the common law rule that insiders should reveal material insider information before trading)).

159. *Enron*, 284 F. Supp. 2d at 565-66; *cited with approval in In re* Elec. Data Sys. Corp., ERISA Litig., 305 F. Supp. 2d 658, 673 (E.D. Tex. 2004).

160. *Id.* at 566.

161. *In re* WorldCom, Inc., ERISA Litig., 263 F. Supp. 2d 745, 765-67 (S.D.N.Y. 2003). However, note the different analysis the court gave with respect to Ebbers as opposed to the members of the board of directors as a whole, finding that members of a corporation's board of directors were not "ERISA fiduciaries" simply because of their control of the corporation and alleged authority to appoint and remove plan fiduciaries. *Id.* at 760-61; *see* text accompanying note 107.

162. *WorldCom*, 263 F. Supp. 2d at 765.

163. *Id.*

164. *Id.* at 765-67.

complaint did not allege that the defendants failed to disclose nonpublic material information to plan participants, but instead, "[w]hat is required, is that any information that is conveyed to participants be conveyed in compliance with the standard of care that applies to ERISA fiduciaries."[165] Furthermore, the court noted that there may be circumstances where securities laws and ERISA are in conflict, but not in this case.[166]

Unlike *Enron* and *WorldCom*, however, the court in *In re McKesson HBOC*, did find a conflict between security laws and ERISA.[167] The court held, "[n]ot even a fiduciary acting in its fiduciary capacity is permitted to engage in insider trading. Fiduciaries are not obligated to violate the securities laws in order to satisfy their fiduciary duties."[168] Additionally, the court found that any alternatives which prevented violation of securities laws, such as divesting the plan of McKesson stock, would not have avoided the loss to the plan, and, consequently, no damages were sustained by the plaintiffs.[169]

The law surrounding the duty to accurately inform is not at all settled amongst the circuits. Although there is a rather clear duty not to misrepresent or defraud employees regarding their retirement plans, there are still questions as to when a fiduciary is acting within his fiduciary capacity and whether or not a duty to be truthful arises only when employees ask for information or, in more liberal interpretations, any time when silence would harm the participants.[170] To complicate matters even more, courts disagree as to whether or not ERISA fiduciary duties conflict with federal securities laws and if so, how to deal with that conflict. These are issues that were not directly dealt with in *Varity Corp.* and courts have taken varying approaches as to when or if a fiduciary duty attaches. As a result, directors need to be aware of the possible liability they may face for misrepresentations and/or omissions and be prepared to adequately deal with situations where a conflict may arise.

The nature of 401(k) plans should persuade courts that misinformation, whether actively conveyed or through silence, significantly impacts the desired advantages associated with such plans. Typically, 401(k) plans are established to allow the individual employees to choose amongst several investment options which plan is best for them. To effectuate the purpose of 401(k) plans, employees must be provided with accurate information regarding the plan's assets. Otherwise, when a participant is subject to improper influence by the employer or other plan fiduciary, or if a plan fiduciary conceals material

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165. *Id.* at 767.

166. *Id.*

167. *In re* McKesson HBOC, Inc. ERISA Litig., 29 Employee Benefits Cas. 1229, 2002 U.S. Dist. LEXIS 19473, at *20-24 (N.D. Cal. Sept. 30, 2002). *But see* Rankin v. Rots, 278 F. Supp. 2d 853, 874 (E.D. Mich. 2003) (agreeing with both the DOL's Brief in *Enron*, which the *Enron* court mostly adopted, and *Worldcom*, but disagreeing with *In re McKesson HBOC*).

168. *In re McKesson*, 2002 U.S. Dist. LEXIS 19473, at *21.

169. *Id.*

170. *See supra* text accompanying notes 143, 147, 167; *see also* Schmall, *supra* note 28, at 901.

nonpublic information, the participants' exercise of control is no longer independent.[171] Although a participant does not have the right to obtain investment advice from a fiduciary,[172] they should at least have the right to obtain the necessary information in order to make prudent investment decisions on their own.

Nevertheless, to prevent the demise of 401(k) plans, directors cannot be placed in a situation where they are forced to either disseminate nonpublic information that is harmful to their company and which they are not required to disclose, or face potential ERISA liability. That result may likely cause directors to simply choose to stop offering 401(k) plans, thereby avoiding the choice between disclosure and liability. The solution is to analyze the duty of misrepresentation and omission under the same guise as monitoring and overseeing responsibilities. If directors have an obligation to appropriately monitor and oversee those they appoint as plan administrators, it only makes sense to require the directors to disclose information which they know or reasonably should know to plan administrators so that they can effectively carry out their duties. Additionally, if the plan administrators do not utilize the information effectively, the directors should have a duty to take remedial action, which may lead to replacement of the plan administrator(s). *Enron* took this one step further by finding that the directors may be liable for failure to disclose to plan participants in special circumstances where there is a potentially "extreme impact" on the ERISA plan as a whole and plan participants generally could be materially and negatively affected.[173] The language in *Enron*, however, should assure directors that the court will likely only find liability for nondisclosure to plan participants in highly extreme circumstances of plan mismanagement.

Although directors cannot affirmatively mislead plan participants, only under severe and extreme circumstances of harm to a plan *might* a director be required to disclose nonpublic information to plan participants.[174] Therefore, with the exception of the above caveat, directors' duty of misrepresentation and omission should be analyzed congruently as part of their duty to monitor and oversee plan administrators. If courts take such an approach, directors will avoid conflict with federal securities laws, and they will be able to effectively fulfill their duties under ERISA without being subject to overly burdensome responsibilities. The directors will need to simply pass on the appropriate information to the plan administrators and thereafter ensure that these administrators are effectively using such information when managing plan assets.

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171. *See* 29 C.F.R. § 2550.404c-1(c)(2) (2005).

172. *See id.*

173. *In re* Enron Corp. Sec., Derivative & "ERISA" Litig., 284 F. Supp. 2d 511, 559 (S.D. Tex. 2003).

174. As noted in this section, courts have taken varying views on whether or not there is a duty placed upon directors to disclose material information to plan participants or even to plan administrators.

IV. Advice to Directors to Reduce Their Potential Liability

After analyzing the various situations in which directors have been found to breach their fiduciary duties under ERISA, it is important to determine what procedures directors can put into place to avoid such breaches. If directors can put cost-effective preventative measures into place to avoid liability for plan losses, they will not have to absorb the cost of potential litigation, and, consequently, they will find it less burdensome and costly to offer 401(k) plans in the future. Furthermore, by implementing such measures, directors will help avoid plan losses in the first place. The ultimate goal of ERISA—to safeguard retirement security—is satisfied under both rationales. The following procedures will essentially create a favorable situation for both directors/employers and employees.

A. Striving to Meet 404(c) Requirements

Directors should first look to ERISA to determine if they can structure their 401(k) plan to meet the requirements of ERISA section 404(c).[175] This particular section of ERISA shields fiduciaries from liability from plan losses if certain conditions are met. According to the DOL in their brief against Enron, the "only circumstances in which ERISA relieves the fiduciary of responsibility for a participant-directed investment is when the plan qualifies as a 404(c) plan."[176] Section 404(c) arises when a plan provides for individual accounts and permits a participant to exercise control over the assets in his account, but only *if* a participant exercises control over the assets in his account according to regulations determined by the Secretary of Labor.[177] As a result, when the conditions of section 404(c) are met:

> (A) such participant or beneficiary shall not be deemed to be a fiduciary by reason of such exercise, and
> (B) no person who is otherwise a fiduciary shall be liable under this part for any loss, or by reason of any breach, which results from such participant's or beneficiary's exercise of control.[178]

Unfortunately for directors, the Secretary of Labor has imposed rather exacting standards so as to limit the utility of section 404(c). For this reason, in many cases, the 401(k) plan will not meet the requirements of section 404(c) and directors should therefore be cautious when relying on its protection. The burden to prove that the requirements of section 404(c) are met lies with the fiduciary

175. ERISA § 404(c), 29 U.S.C. § 1104(c) (2000).

176. Amended Brief of the Secretary of Labor, *supra* note 85, at 35.

177. *Id.*; ERISA § 404(c), 29 U.S.C. § 1104(c).

178. ERISA § 404(c)(1)(A)-(B), 29 U.S.C. § 1104(c)(1)(A)-(B).

defendant.[179] In addition, under the analysis provided by *In re Unisys*,[180] to qualify for the protection afforded by 404(c), the defendant must also show that the participant's or beneficiary's control was a cause-in-fact, as well as a substantial contributing factor, in bringing about the loss incurred.[181]

The regulations imposed by the Secretary of Labor, through the DOL, focus on the participant's ability to exercise meaningful, independent control over the investment of his account.[182] For these regulations to be met, the participant must have the opportunity to: "[c]hoose from a broad range of investment alternatives and diversify investments within and among investment alternatives; [g]ive investment instruction with a frequency which is appropriate in light of the market volatility of the investment alternatives; [and o]btain sufficient information to make informed investment decisions."[183] Although these standards do not appear overly demanding, further specifications by the DOL illustrate why it is often difficult for companies to comply with 404(c) regulations.[184]

For example, a 401(k) plan must afford participants the opportunity to invest in at least three different investment alternatives with the "core investment alternatives" meeting specified requirements.[185] These requirements concentrate on diversification, risk and return characteristics, and the effect of the overall combined investments.[186] Essentially, these requirements "have prompted most

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179. *See* Allison v. Bank One-Denver, 289 F.3d 1223, 1238 (10th Cir. 2002); *In re* Unisys Sav. Plan Litig., 74 F.3d 420, 446 (3rd Cir. 1996); *see also* Rankin v. Rots, 278 F. Supp. 2d 853, 873 (E.D. Mich. 2003).

180. *In re* Unisys, 74 F.3d 420 (3d Cir. 1996).

181. *Id.* at 445. The case provides for a more detailed understanding of the difficulty in meeting the section 404(c) requirements.

182. 29 C.F.R. § 2550.404c-1(b) (2005).

183. Thomas R. Hoecker, *Applying ERISA'S Fiduciary Standards to 401(K) Plans*, VLR9914 ALI-ABA 91, Section H-1. (2000); *see* Colleen E. Medill, *Stock Market Volatility and 401(K) Plans*, 34 U. MICH. J.L. REFORM 469, 522-26 (2001) (outlining the framework of the employer's 404(c) regulations defense).

184. This Note is meant to provide the reader with a basic understanding of 404(c) within the context of director liability, rather than provide a comprehensive guideline illustrating how to comply with 404(c) regulations.

185. Hoecker, *supra* note 183, at Section H-2.

186. Those requirements include:

- Each core investment alternative must be diversified.
- Each core investment alternative must have materially different risk or return characteristics.
- When aggregated, the core investment alternatives must enable the participant or beneficiary by choosing them to achieve a portfolio with aggregate risk and return characteristics at any point within the range normally appropriate for the participant or beneficiary.
- Each core investment alternative, when combined with investments in the other alternatives, must tend to minimize through diversification the overall risk of the

advisors to conclude that a Participant Directed Investment Program must offer, at a minimum, a stock fund, a bond fund and a money market (or similar) fund."[187] Furthermore, the "volatility rule" within the regulations requires that, at a *minimum*, participants must be allowed to give instructions with respect to their investments no less than once every three months. However, this is merely a *minimum* and some investment alternatives will require more allowable adjustments by plan participants.[188] The most exacting regulations, however, come from the information requirements imposed by the DOL and "[c]omplying with these information requirements proves to be the downfall of many plans."[189] According to the regulations, a participant who exercises control over his investments can only do so if he is able to obtain the relevant information to make informed investment decisions. Some information must be produced upon request while other information must be produced automatically.[190] The information requirements are numerous, including, but not limited to, an explanation of the plan, description of investment alternatives, identification of managers, description of fees or expenses, information surrounding the assets within the plans, and various voting rights and restrictions.[191] Remarkably, these

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participant's investments.

Id.; *see* 29 C.F.R. § 2550.404c-1(b)(3)(i)(B).

187. Hoecker, *supra* note 183, at Section H-2.

188. *Id.* at Section H-3; 29 C.F.R. § 2550.404c-1(b)(2)(i)(C) (2005).

189. Hoecker, *supra* note 183, at Section H-4.

190. *See id.*

191. The various regulations relating to information disclosure include:

[1.] An explanation that the plan is intended to constitute an ERISA section 404(c) plan and that plan fiduciaries may be relieved of liability for losses which are the result of participants' investment instructions.

[2.] A description of the investment alternatives available under the plan, including a general description of the investment objectives and the risk and return characteristics of each alternative.

[3.] Identification of any designated investment managers.

[4.] An explanation of how to give investment instructions, any limits or restrictions on giving instructions and any restrictions on the exercise of voting, tender or similar rights.

[5.] A description of any transaction fees or expenses which are charged to the participant's account.

[6.] Immediately following an investment in an investment alternative subject to the Securities Act of 1933 (such as a mutual fund or other publicly traded investment), a copy of the most recent prospectus, unless the prospectus was furnished immediately before the participant's investment.

[7.] Subsequent to an investment, materials provided to the plan relating to the exercise of voting, tender or similar rights, to the extent such rights are passed through to participants.

[8.] A description of the information available on request and the name, address and phone number of the plan fiduciary responsible for providing that information.

are only the more basic regulations concerning 404(c) plans. For example, when dealing with employer securities, further distinctive requirements must be met,[192] as is also true of various other types of plans.[193]

Enron, which thought it had complied with section 404(c), was sadly mistaken. According to the DOL, Enron never explained that the plan was intended to constitute a plan described in section 404(c) and consequently did not meet the information requirements mandating disclosure.[194] Moreover, the DOL argued that Enron did not demonstrate that it had met any of the specific requirements relating to the investment in employer stock.[195] As a result, the DOL argued that Enron retained "full fiduciary responsibility for all of the plan's investments."[196]

Although difficult to establish, directors should make an effort to comply with section 404(c) requirements so as to avoid liability for plan losses if they can establish that they adequately fulfilled the statute's requirements. While the costs of complying with section 404(c) might be high and the regulations somewhat burdensome, the overall benefit would be worthwhile if the directors and company avoid liability for losses to plans, especially if they can make that

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> As noted above, certain information must be provided only on request. Information which is required to be provided on request includes:
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> - A description of the annual operating expenses borne by investment alternatives, such as investment management fees.
> - Copies of any prospectuses, financial statements and reports and other information furnished to the plan relating to an investment alternative.
> - A listing of assets comprising the portfolio of an investment alternative which holds plan assets, the value of such assets and, in the case of such assets which are fixed rate investment contracts issued by a bank, savings and loan association or insurance company, the name of the issuer of the contract, the term of the contract and the rate of return on the contract.
> - Information concerning the value of shares or units in investment alternatives available to participants, as well as information concerning the past and current investment performance of the alternative.
> - Information concerning the value of shares or units in investment alternatives held in the account of the participant.

Hoecker, *supra* note 183, at Section H-4; *see also* 29 C.F.R. § 2550.404c-1(b)(2)(i)(B)(2); Medill, *supra* note 183, at 525-26 (outlining the information requirements).

192. *See* 29 C.F.R. § 2550.404c-1(d)(2)(ii)(E)(4).

193. *See generally* 29 C.F.R. § 2550.404c-1.

194. Amended Brief of the Secretary of Labor, *supra* note 85, at 35-36.

195. *Id.* at 36.

196. *Id.* at 35-36. Although not explicitly noted by the DOL, there is a good argument that Enron failed to meet several other requirements under section 404(c). *See, e.g.*, Fred Reish & Debra Davis, Reish Luftman, Reicher, & Cohen, *The DOL's Enron Brief: What It Means for 401(k) Investments* (Apr. 2003), *at* http://www.reish.com/publications/article_detail.cfm?ARTICLEID=393 (discussing the other requirements under section 404(c) that Enron arguably failed to meet).

claim in a summary judgment motion. In the event that the section 404(c) requirements are not met, the directors have still placed themselves in a better position to avoid liability than if they had not followed the regulations, since the various regulations help ensure that the directors complied with their fiduciary obligations. Furthermore, the regulations provided by the DOL help ensure that plan participants will be protected and that they will receive the necessary information to make informed investment decisions. However, given the difficulties in establishing a section 404(c) defense, directors should not rely solely on its protection. Accordingly, the following recommendations outlined in this Note should be utilized by directors who also believe they qualify under section 404(c).

B. *Effectuating Various Other Procedural Safeguards*

One of the most important procedures a director should follow to reduce potential liability and to ensure the maintenance of an effective 401(k) plan is to adequately delegate responsibilities for administration of the plan to a competent plan committee.[197] The committee should be "separate, distinct and independent from the board of directors and should not include any overlapping members."[198] As illustrated by the various cases outlined in this Note, breaches of fiduciary duty often arise when there is a conflict of interest, which typically occurs as a result of overlapping roles of the directors as plan administrators or by the directors' direct or indirect control of the administrators' decisions. The cost-effective preventative measure of hiring an independent competent plan committee greatly reduces the impression that they are involved in a conflict of interest with regard to plan investments. The directors, prior to choosing any members to serve on the committee, should fully disclose the ERISA fiduciary duties and obligations attached to the members with regard to their position.

The committee plan should meet between two to four times per year, depending on the size of the plan. They meet to monitor the investment options, to discuss the "relevance of any factor in a fund that could affect its continued suitability" and to decide the "inclusion or elimination of the funds from the line-up."[199] Additionally, the committee should also "address the administrative functions of the plan," but separate committees may be necessary as the plan grows.[200] According to Trisha Brambley of *Employee Benefit News*, it is further advisable that the committee be comprised of approximately four to seven senior executives from human resource, finance, and operations, again depending on the

197. *See* Glenn E. Kakely, Milliman USA, *Employer Stock in a Plan: Is It a Mistake?*, (Dec. 17, 2002), *at* http://www.milliman.com/pubs/EBCaseStudy17_Employer_Stock.PDF.

198. *Id.*

199. Trisha Brambley, *401(k) Oversight Committees: Foundation for Fiduciary Responsibility*, EMPLOYEE BENEFIT NEWS, Oct. 2003, *available at* http://www.benefitnews.com/pfv.cfm?id=5140.

200. *Id.*

size of the plan.[201] Brambley also recommends that subcommittees of employees from different divisions within the company be allowed to attend meetings periodically to give employees a "voice regarding the plan," but should not be given a vote, as those decisions are better left to qualified committee members.[202]

Furthermore, the directors should require that committee members implement guidelines for monitoring the performance of the investment options and maintain detailed records of their procedures. As part of the directors' oversight responsibilities, it is critical that the board have access to all committee meeting minutes and records of activity kept by the committee. The procedures followed by the committee should further be organized into the committee's plan investment policy—a written statement that addresses the procedures utilized by the committee to determine plan alternatives and investments, particularly if such investments are in company stock.[203] Milliman USA, one of the largest independent actuarial consulting firms in the United States, advises that a written investment policy address eleven specified issues. After the directors have appointed a qualified committee team to administer the 401(k) plan, they need to review the committee's investment policy to determine whether it adequately addresses the following eleven issues:

[1.] The plan's goals and objectives
[2.] The specific criteria for selecting investment managers, mutual funds and other investments
[3.] Guidelines as to how funds will be monitored
[4.] Standards as to what benchmarks will be used for review of investment performance
[5.] Minimum acceptable investment returns
[6.] A procedure to follow if a fund fails to meet investment expectations
[7.] A policy with respect to fund manager changes
[8.] An annual investment audit procedure
[9.] Guidelines for the evaluation of plan expenses
[10.] A policy with respect to participant education
[11.] A record retention policy to prove compliance.[204]

In addition to the above issues, other advisors have urged that plan committees specifically identify the types of due diligence fiduciaries should undertake in their selection and monitoring of plan assets and in their record keeping.[205] A written plan investment policy that addresses all of these issues will significantly

201. *Id.*

202. *Id.*

203. Kakely, *supra* note 197.

204. *Id.*; *see also* Reish Luftman Reicher & Cohen, *Testimony Before the ERISA Advisory Council on Behalf of the American Society of Pension Actuaries* (Sept. 19, 2002) [hereinafter *Testimony Before the ERISA Council*], *at* http://www.reish.com/practice_areas/EmpBenefits/testimony.cfm (listing issues that a written investment policy statement should cover).

205. *See Testimony Before the ERISA Council*, *supra* note 204.

reduce the risk of plan losses, thereby reducing the risk of liability to directors. Additionally, after directors hand over responsibility of plan decisions to a qualified plan committee, the directors are not required to reevaluate the plan committee's decisions. Their duty is to ensure that the committee follows the proper procedures in making those decisions, thus the importance of the written plan investment policy.[206]

As noted in one of the eleven criteria by Milliman USA, the directors should also require disclosure of certain information to plan participants. The DOL issued an interpretive bulletin explaining how employers can offer investment-related education information to participants, without the information being considered investment advice pursuant to ERISA, after employers expressed liability concerns associated with providing investment information.[207] The allowed educational information includes information regarding the plan, general financial and investment information, asset allocation models, and interactive investment materials.[208] The Securities and Exchange Commission further advised that employers who divulge information listed within the DOL guidelines would not be subject to registration or regulation under the Advisors Act.[209] When plan participants are provided greater information about their plans, the directors' oversight responsibilities are alleviated to some extent because the employees will have a shared responsibility to effectively utilize that information.

C. Obtaining Fiduciary Liability Insurance

Finally, after the directors have established effective procedures to ensure the successful maintenance of a 401(k) plan, they should further protect themselves from personal liability by obtaining fiduciary insurance. Fiduciary liability insurance is intended to cover fiduciaries from claims arising out of an alleged failure to prudently act under the dictates of ERISA.[210] Such insurance should provide a wide protection to the sponsor employer and its officers, directors and

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206. While these are some of the more significant requirements that need to be addressed by the directors, there are other numerous and complex issues the plan committee must work through in establishing a high quality, well-designed 401(k) plan that complies with ERISA regulations. Directors should encourage the committee to consult with outside professionals in creating and maintaining a 401(k) plan that fits the particular needs of their company and its employees. For example, as illustrated above, a company that wishes to meet 404(c) regulations will face highly complex requirements that often can be navigated only with help from specialized advisors.

207. Department of Labor Interpretative Bulletin Relating to Participant Investment Education, 29 C.F.R. § 2509.96-1(d) (2005).

208. *Id.*

209. Interpretive Bulletin 96-1, Participant Investment Education, Final Rule, 61 Fed. Reg. 29586 (June 11, 1996) (to be codified at 29 C.F.R. pt. 2509)

210. INSURECAST, *Fiduciary Liability Insurance*, *at* http://www.insurecast.com/html/fiduciary_liability_insurance.asp (last visited Apr. 19, 2005).

employees from their liability exposures arising from ERISA.[211] For example, Blais Excess & Surplus Agency of Texas, Inc. ("Blais"), is one of the many insurance companies that offers fiduciary insurance. The Blais insurance program:

> Covers past, present and future directors, officers, [and] . . . the plans for actual or alleged wrongful acts. Wrongful act includes a violation of any responsibility, obligation or duty under ERISA . . . . Provides payment of defense costs, settlements and judgments for damages for which an insured is legally liable. Also provides coverage for administrative errors and omissions claims. Potential claimants include plan participants, the Department of Labor and other federal agencies.[212]

There are two other types of coverage related to fiduciary liability insurance.[213] The employee benefit liability insurance covers mostly administrative errors.[214] Coverage will normally include specific errors or omissions with respect to administration of the plan, for example, failing to enroll an employee in the plan or providing improper advice as to benefits. The other type of coverage is fidelity bonds. These bonds are required by law and cover situations involving dishonest administrators or trustees who have financially harmed an employee benefit plan. The bonds can only be used for the benefit of the plan and the plan's beneficiaries, and is not a protection against liability claims.[215]

While fidelity bonds are required under ERISA, fiduciary liability and employee benefit liability insurance are not. Nevertheless, directors should have both types of insurance to ensure that they are adequately protected against liability with regard to their 401(k) plan. There are numerous companies that offer such insurance and many different policy plans for companies to choose from. Therefore, directors should carefully review their company's insurance coverage to determine if they feel comfortable with the protection afforded to them, searching for better alternatives if they believe their current plan is deficient.

However, even with insurance coverage, directors should be every bit as cautious about violating their fiduciary duties, because directors defending ERISA fiduciary claims typically have more at stake than their insurance covers.

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211. TENNANT RISK SERVS. INS. AGENCY LLC, *Fiduciary Liability Insurance*, *at* http://www.tennant.com/p-fiduciary.html (last visited Apr. 19, 2005).

212. BLAIS EXCESS & SURPLUS AGENCY OF TEXAS, INC., *Fiduciary Liability Insurance*, *at* http://www.blaisexcess.com/fili_tables.html (last visited Apr. 19, 2005).

213. INSURECAST, *supra* note 210.

214. The Insure Cast Fiduciary Liability Insurance includes both fiduciary liability and employee benefits liability insurance under one plan. This may or may not be advantageous, and will depend on the particular situation of the insured. *Id.* Thus, it is important for directors to discuss the pros and cons of combining the plans in one policy, because insurers have a tendency to combine the insurance – which may not be the preferable option for the insured. *Id.*

215. *Id.*

For example:

> While Enron carried $85 million in fiduciary liability insurance to cover lawsuits related to benefit plan losses and another $350 million for directors' and officers' insurance "to protect the company and top officials from liability if they are sued," the availability, as well as the sufficiency, of these and other funds to pay any forthcoming judgment is questionable.[216]

Consequently, although it is important for directors to have fiduciary liability insurance, it is even more important that they establish proper procedures to ensure that plan assets are prudently invested. While complying with section 404(c) regulations is one way for directors to avoid liability, the difficulty in meeting all of the numerous and complex requirements of section 404(c) should discourage directors from relying entirely on the safe harbor provision for protection. Instead, in addition to striving to meet section 404(c) requirements, directors should establish an effective system to properly oversee and review plan investment decisions.

CONCLUSION

Until recently, a company's board of directors may not have paid much attention to their company's 401(k) asset allocation and performance. However, corporate directors are increasingly realizing that their 401(k) plans could become the source of significant personal liability if they do not take proper precautions to prevent plan losses. In light of the upsurge in recent corporate scandals involving 401(k) losses and the height of media attention focused on such scandals, it is likely that courts will interpret ERISA fiduciary duties more broadly, serving as a cautionary tale to directors who participate in the management of these plans, even if their involvement is merely appointment of plan administrators. The *Enron* decision and the DOL's stance in that case both illustrate a trend toward stricter enforcement of ERISA obligations upon corporate directors. As litigation over 401(k) plan losses increases, it is crucial that directors understand their fiduciary obligations under ERISA so that they can initiate necessary procedures to prevent plan losses, thereby avoiding personal liability.

The goal of ERISA is to safeguard employees' retirement funds from corporate mismanagement. In scrutinizing directors' fiduciary obligations with regard to plan assets broadly, the courts are effectuating this goal by forcing

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216. Janice Kay Lawrence, *Pension Reform in the Aftermath of Enron: Congress' Failure to Deliver the Promise of Secure Retirement to 401(K) Plan Participants*, 92 KY. L.J. 1, 32 (2003) (quoting, in part, John Keilman, *No Assurance of Enron Insurance Payouts: Some Firms Try to Void Policies*, CHI. TRIB., Feb. 24, 2002, at 1). "[T]ypically, money from both kinds of insurance goes first for defense costs, and Enron has already asked a bankruptcy judge for permission to use $30 million to pay the legal expenses of current and former officials." *Id.* at 32 n.161 (quoting Keilman, *supra*, at 1); *see also* Manning, *supra* note 20; *supra* notes 21-23 and accompanying text.

directors to take measures to prevent plan losses. While this is necessary to provide retirement security to American employees, if the courts impose overly burdensome obligations on directors, companies may no longer offer retirement plans because they are too costly. As a result, instead of effectuating the goals of ERISA, the courts may actually cause a decline in retirement security. Thus, the courts should seek a balance that provides the necessary incentives for directors to effectively carry out their obligations as ERISA fiduciaries, while also continuing to provide an incentive for directors to offer 401(k) plans. That balance can be achieved by holding directors liable only for mismanagement of plan assets for which they could have prevented through careful review of plan investment decisions and the procedures followed in reaching those decisions. Only if the directors are on notice of fiduciary violations, or would have been on notice had they been attentive to the actions of the plan committee, should the directors be found liable for plan losses. However, if there does not appear to be any misconduct on the part of the plan committee members in reaching their investment decisions, the directors should not be expected to do their own evaluation or investigation into the prudence of plan investments.

Directors will be personally liable when they fail to meet their ERISA duties of monitoring plan assets by careful review; however directors can avoid liability by putting into place cost-effective preventative measures that ensure that proper procedures are followed with regard to the investment of plan assets. Therefore, directors can avoid liability, continue to offer 401(k) plans, and effectively monitor plans, all of which effectuate the goal of ERISA—to provide retirement security.

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