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LEGAL ALERT

Legal Alert: Best Practices for Avoiding Fiduciary Litigation under ERISA (Part I)

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The times are scary. Bailouts, plan failures, layoffs, bankruptcies, corporate takeovers. The market is a bear.

In these trying times, allowing your employees to be free to direct their own financial future is not always foolproof. With corporate scandals and collapses in companies such as Enron and Worldcom, employees are angry, and may look to you for guidance – or blame – if their 401k accounts lose money or are depleted.

In the last two years, we have seen a rise in ERISA litigation brought against fiduciaries, including administrators of 401k plans. Many times these fiduciaries did not realize their status under ERISA until it was too late.

Identifying a fiduciary is not always easy under ERISA. Persons are deemed to be fiduciaries based on the work and services they perform on behalf of the plan, not necessarily by their job title.

Under ERISA, a fiduciary includes any person who -

a. Exercises discretionary authority or control with respect to the management of a plan,

b. Exercises any authority or control respecting management or disposition of plan assets,

c. Has discretionary authority or responsibility in the administration of the plan, or

d. Provides investment advice for a direct or indirect fee with respect to money or property of the plan.

A seminal case examining whether certain types of employer activities were fiduciary functions is the U.S. Supreme Court's 1996 decision in *Varity Corp. v. Howe*. In that case, Varity Corporation decided to transfer poorly performing divisions in one subsidiary to another. The company later held a meeting to assuage the concerns of employees of the failing subsidiary who were worried about their benefits, among other things. At this meeting, the company assured employees that their benefits would remain secure when they transferred to the other subsidiary's self-funded plan when, in fact, the company knew that this was not the case.

Still, the company maintained it could not be liable for breach of fiduciary duty under ERISA because it held that meeting in its settlor function. The Supreme Court disagreed, and held that the company was communicating as both an employer and plan administrator at that meeting. Wearing these two hats triggered Varity Corporation's fiduciary duties, which the Court determined the company ultimately breached.

Once an employer assumes a fiduciary role, there are generally four key duties that it owes: loyalty, prudence, diversification of assets, and following the terms of the plan. Of these duties, employers increasingly are giving short shrift to their duty of prudence.

ERISA requires fiduciaries to act as a prudent person would act in a similar situation. This generally is measured by an objective standard, *i.e.,* how an expert in that situation would act. A fiduciary's lack of familiarity or expertise is not an excuse for failing to exercise prudence. Prudence looks at the process that the fiduciary undergoes in reaching a decision. The duty to investigate and consult with outside experts when needed, therefore, can be critical to a finding of prudence.

The bottom line:

Employers should identify fiduciaries in their plan documents and give them written guidance on their responsibilities under ERISA. Training your employees on the front end is one step toward prudence.

If you have any questions regarding the issues addressed in this Legal Alert, feel free to contact any member of Ford & Harrison's Employee Benefits Practice Group.