

# Choppier Waters Ahead For ERISA Fiduciaries

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The first substantive decision under the Employee Retirement Income Security Act has been issued in the class action suit against Enron, *In re Enron Corp. Securities, Derivative and "ERISA" Litigation (Tittle v. Enron Corp.)*. Significantly, the court supported the creation of heightened fiduciary standards.

## BRIEF BACKGROUND OF *TITTLE*

The plaintiffs in *Tittle* consist of a class action group of Enron employees who were participants in Enron's three ERISA covered employee benefit plans: (1) the Enron Corporation Savings Plan (Savings Plan); (2) the Enron Corporation Employee Stock Ownership Plan (ESOP); and (3) the Enron Corporation Cash Balance Plan (Cash Balance Plan).

The defendants fall into five groups: (1) Enron and its individual officers and directors; (2) the committees, trustees, and individuals that administered the three employee benefit plans; (3) Enron's accountant and some its individual partners and employees; (4) Enron's outside counsel and some of its individual partners; and (5) five investment banks.

The plaintiffs alleged nine counts in their complaint that fall into three broad categories: (1) breach of ERISA's fiduciary and co-fiduciary duties (five counts); (2) conspiracy to commit unlawful acts or omissions designed to mislead and defraud Enron employees under the Racketeer Influenced and Corrupt Organizations Act (RICO) (two counts); and (3) negligence and civil conspiracy under Texas common law (three counts).

In *Tittle*, the court was asked by each of the defendants to dismiss the plaintiffs' claims made against them. In ruling on this motion to dismiss, the court assumed all of the plaintiff's factual allegations were true and was determining whether the claims had a legal basis to go forward. In general terms, the court refused to dismiss the plaintiffs' causes of action, ruling that if all of the plaintiffs' allegations were correct then the plaintiffs' had provided sufficient evidence in their complaint to support a ruling that Enron and its officers and directors breached their ERISA fiduciary duties by, among other actions, initiating a lockdown

that prevented participants from accessing the assets held in their employee benefit plan accounts, and that certain Enron former executives, including Kenneth Lay, could be liable for fiduciary breach under ERISA for extensively promoting Enron stock and inducing employees to invest their retirement account assets in company stock despite knowing the price of the stock was inflated. This article focuses on the counts related to the breach of ERISA's fiduciary and co-fiduciary duties.

## ROUGH WATERS UP AHEAD?

The *Tittle* court found that the plaintiffs adequately stated claims for breach of the ERISA fiduciary duties of loyalty and prudence against Enron, the board members on Enron's Compensation and Management Development Committee (Compensation Committee), and Kenneth Lay because "they were given the power to appoint, retain and remove plan fiduciaries ... and because they allegedly exercised that discretionary authority of appointment over the management or administration of a plan." Further ruling that such defendants were expressly responsible for the selection and, therefore, the monitoring of the Administrative Committee (the Plan Administrator) regarding its control over plan investments and the prudence of investing in Enron stock, the court held that, "[a]s such, they had a duty to insure that the selected fiduciaries in turn complied with their fiduciary duties." Additionally, the court ruled that the plaintiffs stated a valid claim that these defendants were "liable as co-fiduciaries for their ... failure to monitor their appointees and to supervise the Administrative Committee of the plan regarding the prudence of their decisions to invest assets of the Savings Plan and ESOP in Enron stock."

While the court never expressly states that this equated to a *continuous* duty to monitor the appointed fiduciary, the court may ultimately find that a fiduciary standard of prudence would dictate that to insure the fiduciary compliance of another, the appointing fiduciary would have to continuously monitor the actions of the fiduciary rather than routine monitoring that is done, for example, on a quarterly basis.

The court also found that the complaint stated a valid claim that defendants Enron, Lay, and the Compensation Committee were liable as co-fiduciaries for their "failure to inform the Administrative Committee about Enron's financial status, ... that the Committees failed in their duty to investigate whether the investment options were prudent ... and had no process in place for fulfilling their duty to make prudent investment decisions."

#### **DUTY TO NOT MISLEAD FIDUCIARIES AND PARTICIPANTS**

In addition, the court focused on the fiduciary duty to disclose (through the fiduciary doctrine of loyalty) to participants and beneficiaries material information that could affect their rights and benefits under the plan. The court noted that the duty to disclose was a developing and controversial area of the law with disagreement among the courts. The *Tittle* court explained how some courts find a duty to disclose only in instances where a fiduciary receives a specific request for information. Other courts have found that plan fiduciaries have an affirmative duty to disclose material information that may affect plan benefits and rights to participants and beneficiaries.

The *Tittle* court noted that the Fifth Circuit Court of Appeals (the circuit that includes the Federal Southern District of Texas) imposes the duty to disclose cautiously. However, a recent Fifth Circuit case has recognized "that in addition to a specific inquiry from a plan participant, special circumstances with a potentially 'extreme impact' on a plan as a whole, where plan participants generally could be materially and negatively affected might support the imposition of such an affirmative duty."

The *Tittle* plaintiffs had alleged, in part, general material misrepresentation regarding Enron's financial condition and the inducement of participants to purchase or hold

Enron stock as part of a larger scheme of the defendants to enrich themselves. The *Tittle* court concluded that based on the fiduciaries' duties of "loyalty and of care, skill, prudence, and diligence," the plaintiffs stated a valid claim that Enron, Kenneth Lay, and the Compensation Committee, among others, breached their ERISA fiduciary duties by "failing to disclose information about Enron's dangerous financial condition that they knew or should have known," to participants, plan counsel, or the Administrative Committee, while at the same time individually selling large amounts of Enron holdings.

Significantly, the *Tittle* court rejected the defendants' argument that they did not have a fiduciary duty under ERISA to disclose Enron's failing financial condition to participants and beneficiaries because it would violate insider trading rules under federal securities laws. In reaching this conclusion, the court agreed with the position of the Department of Labor that ERISA fiduciary duties coexist with the securities rules. The court noted that the two statutes:

should be construed not to cancel out the disclosure obligations under both statutes or to mandate concealment ... [rather] ... the statutes 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 ... because continued silence and deceit would only encourage the alleged fraud and increase the extent of the injury.

#### **OTHER ASPECTS OF THE TITTLE CASE**

The *Tittle* court found that, as a threshold matter, the plaintiffs raised material issues regarding whether the Savings Plan qualified as a 404(c) plan that would insulate the defendants from liability from

investment decisions controlled by participants. The court found that the plaintiffs adequately claimed that the Savings Plan did not offer plan participants a sufficiently broad range of investment alternatives nor sufficient access to transfer plan assets among the offered investment alternatives to qualify for 404(c) protection.

The *Tittle* court did not dismiss the plaintiffs' claim that defendants breached their fiduciary duties by instituting a one month lockdown (or blackout period) to switch investment providers just before Enron filed bankruptcy, thus preventing many participants the ability to sell Enron stock, or switch to a different investment alternative. Although the court acknowledged that the lockdown had been scheduled well in advance, because the lockdown was "an extreme threat to the participants' interests in their employee benefit plans," Enron's imminent bankruptcy "should have triggered the trustee's fiduciary duties to its plan participants and beneficiaries to postpone or at least to limit the duration of the scheduled lockdown, as Defendants had the ability to do."

In addition, the court found that the plaintiffs stated a valid claim for a failure to diversify the Savings Plan. The court noted that just before the onset of the lockdown, approximately 60 percent of the Savings Plan's assets were invested in Enron stock. Given all the warning signals that Enron's financial health was quickly worsening, this represented a violation of the fiduciary duty to diversify plan assets.

Also, the court addressed the issue of the potential for directed trustee liability. After lengthy analysis the court concluded that:

even where the named fiduciary appears to have been granted full control, authority and/or discretion over that portion of activity of plan management and/or plan assets at issues in a suit and the plan trustee is

directed to perform certain actions within that area, the directed trustee still retains a degree of discretion, authority, and responsibility that may expose him to liability.... [And where, as was alleged in *Tittle*,] the directed trustee knew or should have known from a number of significant waving red flags ... that the employer company was in financial danger and its stock greatly diminished in value, yet the named fiduciary, to which the plan allocated all control over investment by the plan, directed the trustee to continue purchasing the employer's stock, there is a factual question whether the evidence is sufficient to give rise to a fiduciary duty by the directed trustee to investigate the advisability of purchasing the company stock....

The court also ruled that the defendants had a fiduciary duty to disclose to cash balance plan participants the artificial inflation of Enron stock. Until 1996, the Cash Balance was a traditional defined benefit plan that calculated benefits by adding different percentages of final average pay and multiplying that figure by the levels of years of accrued service and then offsetting that amount by the annuity value of a portion of the participants' accounts in the ESOP. The Cash Balance Plan was amended in 1996 to provide that the offset against the Cash Balance Plan would be the value of one-fifth of the shares of the Enron stock credited to a participant's account was to be calculated based on the price of the stock on that

date. The plaintiffs argued that the artificially inflated prices of Enron stock from 1998 through 2000 resulted in a higher offset of their cash balance plan accounts than what should have occurred. While the plaintiffs dismissed their claim against the cash balance plan itself, the court found that the plan fiduciaries should have disclosed to the cash balance plan participants during that time that the value of Enron stock was artificially inflated.

The court dismissed both of plaintiffs' RICO claims because the court ruled that the RICO claims were based on conduct actionable as securities fraud. The 1995 amendment to RICO eliminated securities fraud as a "predicate act" sufficient to give rise to a cause of action under RICO. Accordingly, the court ruled that both of the plaintiffs' RICO claims were dismissed for failing to allege a "predicate act" that gave rise to valid RICO claims.

Finally, the court dismissed the claims against the five investment banks, outside counsel, and certain individual officers, but the fiduciary breach claims still stand against the remaining defendants.

**CALMER SEAS ON THE HORIZON?**

While *Tittle* suggests stormy seas for ERISA plan fiduciaries, the decision contained a few indications that there may be some rays of sunshine behind the gathering rain clouds. For instance, since this was a ruling on a motion to dismiss, while an appeal may not be the next step, it is possible the rulings will evolve as the facts in the case are further developed.

Also, for plans that clearly have

404(c) protection (which can be very difficult to obtain), the resulting immunization for many aspects of fiduciary liability could make *Tittle* a little less alarming. In addition, in a potential example of the axiom "bad facts make bad law," *Tittle* may prove to be distinguishable for cases with less egregious facts. In fact, the *Tittle* court, in finding that the defendants may have an affirmative duty to disclose material information to plan participants and beneficiaries, underscored the role the "extreme impact" of the defendants' actions played in recognizing this affirmative duty.

Nevertheless, the message to take from *Tittle* is that it represents the latest attempt by the courts to balance protecting participant and beneficiary rights and assets under employee benefits plans against not creating obligations and responsibilities on the part of plan fiduciaries and sponsors that are so onerous that they discourage employers from continuing to sponsor employee benefit plans. And, given the uncertain state of the economy, the overall poor performance of the stock market over the last few years, and the wave of accounting scandals that have shaken the public's confidence in corporate America, the scales may be tipping in favor of more participant and beneficiary protections for the foreseeable future. ☺

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