Court Rules in Enron ERISA Litigation
A Cautionary Tale for 401(k) Plan Sponsors, Boards of Directors and Other Plan Fiduciaries

On September 30, a federal district court in Texas denied motions to dismiss the ERISA claims in the Tittle v. Enron class action. This lawsuit was brought by former Enron employees who held the company’s stock through Enron’s 401(k) and ESOP plans at the time the company filed for bankruptcy in November, 2001. The employees suffered massive losses to their retirement plan savings. The defendants in the ERISA claims included Enron, members of its Board, a number of former executives and employees (including former CEO Ken Lay), as well as institutional trustee Northern Trust Company and Enron’s accountants, Arthur Andersen. This ruling follows a string of recent high profile decisions – including in actions brought against WorldCom, Kmart, and The Williams Companies – involving alleged ERISA violations in connection with retirement plan investments in employer stock. The Enron case is the latest such decision refusing to dismiss claims against plan fiduciaries.

The Enron decision spans some 329 pages. Only the most significant of the ERISA issues are highlighted here. Taken together with other recent employer stock-related decisions, this ruling in many respects represents an expansion of the scope of potential fiduciary liability under ERISA and serves as a cautionary tale to employers with large company stock allocations in their retirement plans, as well as to company officers and directors who appoint plan administrators, to institutional directed trustees, and to other service providers who assist plan fiduciaries. The Enron holding illustrates the following important potential pitfalls associated with investment in employer stock:

• Corporate officers or employees who administer benefit plans on their company’s behalf may be held personally liable as fiduciaries.

• Fiduciaries may be subject to wide-ranging affirmative disclosure obligations that create tensions with the Federal securities laws.

• Institutional trustees with no investment discretion may nonetheless under certain circumstances have relatively expansive affirmative obligations to override the decisions of directing fiduciaries.

• ERISA Section 404(c) may not provide much protection to fiduciaries of 401(k)s or other individual account plans that permit participant control over their investment decisions.

• Service providers that are not fiduciaries, such as accountants, attorneys, actuaries and consultants, may still be held liable under ERISA if they participate in fiduciary breaches.

Liability of Board Members or Others Who Appoint Plan Fiduciaries

One of the many interesting aspects of this and other recent employer stock decisions is the extent to which appointing fiduciaries – i.e., those with the power and authority to select and monitor the plan fiduciaries that are directly responsible for investment decisions – may be liable for the failures of the fiduciaries that they have appointed. In Enron, the court held that Enron’s directors (as well as its former Chairman and CEO Ken Lay) may be responsible as appointing fiduciaries, both because the Board was specifically given appointment authority by the plan documents and because that responsibility ultimately rested with the corporation. In essence, this holding means that where plan documents provide, for example, that “the company shall appoint the trustee...,”
While the court did not address the extent of the appointing fiduciaries’ potential liability, its strong language in this regard suggests that it is prepared to find that an appointing fiduciary that failed to properly appoint or monitor the plan’s primary fiduciaries will be held liable for losses occasioned by any breaches committed by such fiduciaries. Moreover, even when the fiduciary status of Board members is confined to this relatively limited appointment power, under the Enron court’s reasoning, directors may be subject to other wide-ranging obligations under ERISA, including potential affirmative disclosure obligations and co-fiduciary liability. Because the extent of the responsibility of a particular appointing fiduciary is fact-specific, it depends on the terms of the applicable plan documents and any additional role the individual may have undertaken as to the plan. Companies and their officers and directors would be well advised to review this allocation of responsibility.

**Liability of Corporate Officers**

Another important holding in *Enron* is that corporate officers and employees who are appointed by the employer to administer its retirement plan on the company’s behalf may be sued and held personally liable for their conduct. The court noted that there is a split among the federal circuit courts on this matter of personal liability.

**Affirmative Disclosure Obligations**

The court held that the defendants breached their fiduciary duty to affirmatively disclose accurate information about Enron’s financial condition to plan participants assuming the allegations in the complaint are true. Plaintiffs alleged that the defendants breached a fiduciary obligation to affirmatively disclose nonpublic adverse facts about the company that would be material to plan participants in making decisions regarding Enron stock held in their 401(k) plan. While recognizing such an affirmative disclosure obligation is a growing trend in recent ERISA decisions, it has not been universally accepted. In *Enron*, the court held that the plans’ fiduciaries had an affirmative duty to disclose material and potentially harmful facts regarding Enron’s financial condition of which they became aware, even in the absence of inquiry from plan participants and beneficiaries.

The defendants argued that selectively disclosing non-public information about Enron to plan participants would have violated the insider trading rules under the Federal securities laws. While a few of the recent employer stock cases have been sympathetic to this argument, *Enron* rejected this position and ruled that fiduciaries must find a way to comply with both ERISA and the securities laws. The court indicated that the primary way to assure such compliance would have been to simultaneously disclose the material facts about Enron’s financial condition to the employees as well as to other Enron shareholders and the public at large. The court further indicated that the company at a minimum could have halted further investments in Enron’s stock without violating the securities laws, or reported the matter to Federal regulators at the DOL or SEC. While some courts and commenters have criticized this approach as both impractical and likely ineffective (for example, because simultaneous disclosure would result in a falling stock price under the “efficient market hypothesis”), a number of other decisions, including, e.g., *WorldCom*, have reached similar conclusions.

**Directed Trustee Responsibility**

Northern Trust acted as a directed trustee of the Enron plans, with responsibility to invest plan assets pursuant to directions from the responsible fiduciaries and plan participants. The court ruled that regardless of its directed trustee status, Northern Trust was a fiduciary and that, because it knew or should have known from a number of “significant waving red flags” of the dangers of the plans’ investment in the Enron stock, it may be liable under ERISA for failing to override the directions that it received (in this case, the direction to implement a blackout period during which employees could not change their investments). The court rejected the standard proposed by Northern Trust (derived from ERISA’s legislative history and long urged by directed trustees) that as a directed trustee it could be liable only if it had followed directions that clearly on their face contradicted the plan documents or violated ERISA. Instead, under the standard articulated by the court, a directed trustee that knows or should know of adverse facts material to the prudence of a particular investment has a duty to override the directions of the responsible fiduciary (or otherwise take affirmative steps) to protect the plan.
Given the unique circumstances of the Enron case, in particular the confluence of a lockdown period on plan participants at the precise time that Enron’s financial disclosures were causing the stock to plummet, the decision regarding Northern Trust is not surprising. Nonetheless, the decision and other recent rulings like it raise the bar as to the responsibilities of directed trustees. Such institutions will need to review and consider their controls and procedures with regard to employer stock (and plan investments generally) to protect themselves against the risks of this potential liability.

**Section 404(c) Provides Only Limited Protection for Fiduciaries of Individual Account Plans**

Enron also further eroded the protections Section 404(c) of ERISA affords fiduciaries. Section 404(c) shields fiduciaries from liability for losses to a participant’s individual investment account resulting from his or her exercise of control over investment decisions. However, Enron not only found that plaintiffs had alleged sufficient facts to question whether Enron’s plans met the extremely detailed requirements for invoking Section 404(c) protection, as set forth in Department of Labor Regulations, but also ruled that concealment of material non-public facts about Enron’s financial condition prevented the participants from being able to exercise the requisite control over investment decisions needed for Section 404(c) to apply. This decision thus serves as another reminder to plan fiduciaries of 401(k) and other individual account plans of the difficulties of seeking to rely on Section 404(c).

**Responsibility of Non-Fiduciary Service Providers**

Although service providers to ERISA plans, such as accountants, attorneys, actuaries, and consultants, normally are not deemed to be fiduciaries (and thus not directly subject to ERISA fiduciary liability), Enron reaffirms that they may still be held liable under ERISA. The court refused to dismiss an ERISA claim against Arthur Andersen, which served as the company’s outside accounting firm, for its alleged knowing participation in the other defendants’ fiduciary breaches through concealing from plan participants and fiduciaries the truth about Enron’s financial condition and the imprudence of investing in the company stock. The court concluded that the scope of equitable relief available under ERISA permits suits against a non-fiduciary service provider for knowing participation in a fiduciary’s breach.

**Conclusion**

The 329 page Enron ruling is a wide-ranging decision that, taken together with several similar outcomes in the spate of other recent similar cases, expands both the number of potentially responsible plan fiduciaries as well as the scope of their responsibility. Although ERISA was designed to permit a plan to have multiple fiduciaries, each responsible for discrete functions and with co-fiduciary exposure limited to circumstances defined in the statute, the broad effect of these decisions is that any plan fiduciary can potentially be held responsible for plan losses in this context under a variety of theories. Companies sponsoring 401(k) and other retirement plans (particularly those with significant employer stock components) would be well advised to reexamine their programs and procedures in an effort to head off potential liability in this area by evaluating the roles and responsibilities of the company, the Board and plan fiduciaries with regard to plan investments and administering and implementing prudent procedures to ensure compliance with such responsibilities.
Should you have any questions regarding Tittle v. Enron or other recent employer stock cases, please contact Larry Hass at (212) 318-6401, Josh Sternoff at (212) 318-6011, or any of the other members of the Paul, Hastings ERISA – Institutional Investment, Benefits and Compensation Group listed below.

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