

# Basics of ESOP Fiduciary Responsibility and Liability

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# Fiduciary Responsibilities

- **Background.** The fiduciary duties with respect to an Employee Stock Ownership Plan (ESOP) are governed by the Employee Retirement Income Security Act of 1974 (ERISA).
  - **Fiduciary Duties**
    - ERISA is a remedial statute.
    - It was originally enacted to prohibit real or perceived abuses affecting retirement and welfare benefit plans.
    - ERISA has an elaborate scheme relating to preventing the negligent or purposeful misuse of the assets held by retirement or welfare funds.

# Fiduciary Responsibilities

## – Who is a Fiduciary?

- ERISA provides a very broad definition of who is a fiduciary. The term is defined very broadly to include any person or entity who:
  - exercises any discretionary authority or control with respect to a plan; ERISA § 3(21) (A)(i)
  - exercises any authority or control with respect to the management or disposition of a plan's assets; ERISA §3(21)(A)(i)

# Fiduciary Responsibilities

- renders investment advice with respect to a plan's assets for a fee or other compensation or who has authority or responsibility to do so; ERISA §3(21)(A)(ii)
- has discretionary authority or responsibility with respect to the administration of the plan; ERISA §3(21)(A)(iii)

# Fiduciary Responsibilities

- Typically the following persons will be considered ESOP fiduciaries:
  - » Plan trustees;
  - » Plan administrator;
  - » Members of investment or administrative committee;
  - » Investment managers handling non-Company stock held in ESOP; or
  - » Any person who selects or appoints any of these people.

# Fiduciary Responsibilities

## — Functional Test

- There is generally no consent necessary for a person to be considered a fiduciary. If a person is exercising any authority or control over plan assets or performing any of the activities listed above he or she can be a fiduciary. *Mertens v. Hewitt Associates*, 508 U.S. 248 (1993).

# Fiduciary Responsibilities

## – Fiduciary Duties

- Under ERISA, a fiduciary has the following duties:
  - To act solely in the interest of plan participants and beneficiaries; ERISA §404(a)(i)
  - To act for the exclusive purpose of providing benefits to plan participants and their beneficiaries and defraying reasonable expenses in administering the plan; ERISA §404(a)(1)(A)
  - To exercise the same care, skill, prudence and diligence that a prudent person acting in a like capacity and familiar with such matters would exercise in the conduct of an enterprise of a like character and with like aims; ERISA §404(a)(1)(B)

# Fiduciary Responsibilities

- If charged with investing plan assets, to diversify plan investments so as to minimize the risk of large losses (unless it is clearly not prudent to do so under the circumstances) ERISA §404(a)(1)(C); and
- To act in accord with the documents and instruments governing the plan (unless the documents are inconsistent with ERISA). ERISA §404(a)(1)(D)

# Fiduciary Responsibilities

## — Co-Fiduciary Liability

- In addition to his or her own potential liability for failing to satisfy his or her duties under ERISA, a fiduciary may have liability for a co-fiduciary's conduct. A fiduciary is liable for a breach of fiduciary duty of a co-fiduciary if:
  - the fiduciary participates knowingly or in, or knowingly undertake to conceal an act or omission of the other fiduciary, which he knows is a breach; ERISA §405(a)(1)

# Fiduciary Responsibilities

- by his failure to comply with the prudence, diversification or loyalty requirements of ERISA or the failure to follow plan documents in the performance of his own specific duties permits the other fiduciary to breach his duties; ERISA §405(a)(2) or
- the fiduciary has knowledge of the breach by the fiduciary and does not make reasonable efforts to remedy the breach. ERISA 405(a)(3).

# Fiduciary Responsibilities

- **Liabilities for Breaches of Fiduciary Duty**
  - **Personal Liability**
    - A plan fiduciary is personally liable for any losses to the plan resulting from the breach.
    - Any profits a fiduciary made because of a breach must be disgorged and returned to the plan.
    - Generally, punitive damages are not available.
  - **Twenty Percent Penalty**
    - The Department of Labor imposes a 20% penalty for breaches of fiduciary duty.
  - The Plan may not release or indemnify a plan fiduciary for liability.

# Fiduciary Responsibilities

- **Common Issues/Problems for ESOP Fiduciaries**
  - Appointment of the Trustee
  - Plan Amendments
  - Use/Misuse of Corporate Assets
  - Valuation of Company
  - Repurchase Liability Planning
  - Stock Sales/Stock Purchases/Redemptions
  - Outside Purchases
  - Corporate Acquisitions