

Lessons In Fiduciary Duty From Employee Stock Plan Ruling

By **Joshua Sutin, Katherine Noll and Lauren Parker** (May 14, 2021)

Two immediate lessons come to mind after reading *Wilmington Trust NA v. Stout Risius Ross Inc.*

Filed on March 23, the U.S. District Court for the Southern District of New York opinion and order involved a valuation of an underlying employer stock that was found to contain material defects.

The trustee of the employee stock ownership plan, a qualified plan, who conducted the transaction on behalf of the plan participants did not carry out their duties in reviewing the valuation. The trustee was found in breach and paid to settle the judgment.

In turn, the trustee then sued the independent appraiser under New York state law for negligence, breach of contract and contribution.

The court held that the Employee Retirement Income Security Act does not preempt claims such as these against a nonfiduciary even though the judgment for which *Wilmington Trust* was originally held liable was related to an ERISA-based claim.

The first lesson here is that fiduciaries must do their duties, and do them well.

Regarding the trustee's failures, the court stated:

Specifically, *Wilmington* has not demonstrated that its reliance on [the independent appraiser's] report was "reasonably justified" in light of all the circumstances because it has not shown that it thoroughly probed the gaps and internal inconsistencies in that report.

The court outlined *Wilmington's* major failures, including:

- The failure to consider a different report;
- The failure to probe the appraiser's reliance on management's representations and projections;
- The failure to investigate whether it was appropriate for the appraiser to increase the value of *Constellis*, the entity owned by the qualified plan, by applying a control premium; and
- The failure to probe the appraiser's practice of rounding numbers up, thereby increasing *Constellis'* value.

The court found that while any one of these failures alone may not be sufficient to conclude that *Wilmington* failed to meet its duty, the cumulative failures show that *Wilmington* was



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not sufficiently engaged in the Constellis transaction.

The second lesson is that vendors to qualified plans should be on notice that Employee Retirement Security Act preemption will not necessarily help them with state law claims of negligence — if filed timely — contract breaches and contribution claims.

Plan sponsors should take note that they may be able to successfully pursue state law claims against vendors who breach their duties or contracts. However, a plan fiduciary must monitor their vendors as should a good plan settlor.

Had the fiduciary or plan settlor, in this case, carried out the duty to monitor their vendors, this issue may have never come to litigation, which wasted additional resources for everyone involved.

All fiduciaries should understand that they not only need to be sufficiently engaged in a transaction, they must also document how they are diligently reviewing every decision that they have to make to ensure it is in the interest of plan participants.

All employers, trustees and vendors to qualified plans should be intimately familiar with *Acosta v. First Bankers Trust Services Inc.*'s 2017 consent order and judgment for the Southern District of New York as well as with the *Perez v. GreatBanc Trust Co.* consent order and judgment in the U.S. District Court for the Central District of California in 2014.

In both decisions, the court laid out how to select an independent valuation adviser, how to conduct oversight of such an adviser, what financial information to request and review, how to conduct a fiduciary review process, how to document such process, and what document retention processes and related issues fiduciaries should consider.

The U.S. Department of Labor has published the Meeting Your Fiduciary Responsibilities^[1] guide on its website, which includes a section on monitoring the vendors to a qualified plan subject to ERISA.

The guide provides that:

Hiring a service provider in and of itself is a fiduciary function. When considering prospective service providers, provide each of them with complete and identical information about the plan and what services you are looking for so that you can make a meaningful comparison.

In general, the DOL has been very explicit in what it expects a trustee of a qualified plan that will invest in employer securities of a nonpublicly traded company must do to demonstrate they are doing their duties under ERISA.

Further, the DOL also expects the trustee's attorneys to document the processes undertaken by the trustee.

The guide further elaborates on information needed to assess the reasonableness of the compensation — direct and indirect — and determine any conflicts of interest that may affect the service provider's performance. It then lays out additional items and fiduciary needs to consider when selecting a service provider.

Finally, the guide stresses the need for the employer to document its selection, and monitoring, process when using an internal administrative committee, and educating

committee members on their roles and responsibilities. Plan fiduciaries and plan settlors are encouraged to review the DOL website for tools that can help lead and document the process of fulfilling the fiduciary duties required by ERISA.[2]

Practitioners should not only have a deep understanding of these requirements, but have a step-by-step best practices plan on how to implement and document each step in any given transaction — be it purchasing or selling, contemplating purchasing or selling, or receiving an offer to purchase or sell employer securities.

To educate employers and plan officials, equip them with an understanding of the law and their responsibilities as well as outline steps for avoiding the most common problems the Employee Benefits Security Administration encounters in its enforcement activities, EBSA has created the fiduciary education campaign: "Getting It Right — Know Your Fiduciary Responsibilities."

The campaign includes nationwide educational seminars and webcasts to help plan sponsors understand rules and meet their responsibilities to workers and retirees, thereby improving their financial security. The campaign also includes educational materials on topics such as understanding fees and selecting an auditor.

The DOL and third-party organizations offer plentiful other resources for plan sponsors and fiduciaries to stay up to date on relevant issues. Formal fiduciary training programs encompassing not only legal requirements but also best practices in documenting each step in the fiduciary process should also be provided by plan sponsors.

Both lessons, and the entire lawsuit, could have been avoided through a process that is documented to show how the trustee met its duties under ERISA.

Once again, the DOL provides clear good corporate governance policy and procedures to the fiduciary processes they wish to see implemented when plan sponsors of nonpublicly traded companies use their stock to fund a qualified plan or use a qualified plan to purchase such stock.

We believe that an employer who wishes to go down this path can do so safely if they make sure the trustee, the trustee's vendors, the other plan vendors — CPA, ERISA attorney, third-party administrator, insurance broker, etc. — are all following the DOL process and procedures outlined by the DOL.

Further, vendors to qualified plans, fiduciaries and plan settlors now have to think about state law claims if ERISA does not preempt negligence claims as in this case. State law claims can be expensive, waste time and resources, while creating stress on an organization's morale.

Attorneys will now need to counsel their clients on ERISA causes of action, but this case opens up state claims and a whole new level of litigation concerns.

We may see courts being more willing to relax ERISA's preemption and allow state claims to be a new landscape for qualified plan participants, employers and vendors.

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[1] <https://www.dol.gov/sites/dolgov/files/ebsa/about-ebsa/our-activities/resource-center/publications/meeting-your-fiduciary-responsibilities.pdf>.

[2] <https://www.dol.gov/general/topic/retirement/fiduciaryresp>.