

The Role of the Independent Fiduciary in Litigation Settlements

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The Basic Prohibited Transaction Issue Arising from Settlements

The Department of Labor has held that a transaction prohibited by ERISA section 406(a) will occur when a plan fiduciary causes a plan to release a claim against a person who is a party in interest at the time of the settlement. In the Department's view, such a settlement involves "an exchange of property (a chose in action) between such [plan] and parties in interest as described in section 406(a)(1)(A)." DOL Opinion 95-26A, 1995 ERISA LEXIS 38 at *7. Thus, absent a prohibited transaction exemption, participating in a settlement in which the company or another party in interest is a defendant would be a prohibited transaction creating exposure for the fiduciary and a potential excise tax for the party in interest under Internal Revenue Code section 4975. Companies, plan fiduciaries and their counsel generally are aware of this concern as it applies to ERISA settlements. They are less likely to be aware that it arises in connection with other settlements in which a plan is giving a release to the plan sponsor or other parties in interest, such as a securities settlement against a plan sponsor where the plan is a class member because it purchased company stock during the class period. Absent an exemption, the plan's failure to opt out of the settlement would result in a prohibited transaction. Of course, opting out simply to avoid a possible prohibited transaction likely would not be in the interest of plan participants and beneficiaries and thus likely would be a breach of fiduciary duty.

Prohibited Transaction Exemption 2003-39 and the Need for an Independent Fiduciary

Subject to certain limits and conditions, Prohibited Transaction Exemption 2003-39, as amended June 15, 2010, provides an exemption for "The release by the plan or a plan fiduciary of a legal or equitable claim against a party in interest in exchange for consideration, given by, or on behalf of, a party in interest to the plan in partial or complete settlement of the plan's or the fiduciary's claim." Section I(a). One condition is that "The settlement is authorized by a fiduciary (The authorizing fiduciary) that has no relationship to, or interest in, any of the parties involved in the claims, other than the plan, that might affect the exercise of such person's best judgment as a fiduciary." Section II(b).

In the preamble to the original PTE 2003-39, the Department opined that the mere fact that a party in interest pays for the independent fiduciary or advisor to the independent fiduciary would not destroy independence, provided the professional being paid by the party in interest understands that the plan, not the party paying the bill, is the client, and provided the compensation paid to the professional fiduciary or advisor by a party in interest constitutes "no more than a small percentage of such professional's annual gross income." 68 Fed. Reg. at 75,635. The subsequent amendment does not affect this issue.

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In theory a service provider such as the trustee might be able to serve as the authorizing fiduciary if it met the criteria. In practice, service providers carefully limit the extent of their discretion in order to control the risk of liability and will be reluctant, at best, to take on the task of evaluating litigation settlements on behalf of plans. If an existing provider were willing to undertake this role, it likely would insist on separate compensation for the increased responsibility and exposure to litigation.

Finally, note that in the preamble to the proposal the Department stated that “in some instances where there are complex issues and significant amounts of money involved, it may be appropriate to hire an independent fiduciary having no prior relationship to the plan, its trustee, any parties in interest, or any other parties to the litigation.” 68 Fed. Reg. at 75,638. Although this statement was not repeated in the preamble to the final exemption, it was not contradicted or withdrawn. Thus, we understand that it is still the Department’s position.

The Role of the Independent Fiduciary

The independent fiduciary should:

- Determine whether the settlement satisfies the conditions of Prohibited Transaction Exemption 2003-39 (“PTE 2003-39”), including negotiating any changes necessary to protect the interests of the plan and its participants. If so, the independent fiduciary should explicitly authorize the settlement.
- Determine whether the plan should opt out of the settlement if it is an opt-out class.
- Determine whether any objections should be brought on behalf of the plan, and if, so, file the objections.

In a settlement where class members must file claims, the independent fiduciary also may:

- Prepare and file claims on behalf of the plan.
- Determine how the proceeds of the settlement are allocated to participants’ accounts.

PTE 2003-39 does not require the use of an independent fiduciary for these tasks, but an independent fiduciary with experience in these tasks can assure proper filing of the claims to assure maximum recovery and can allocate the proceeds in a manner that is fair to participants.

Findings under PTE 2003-39

The authorizing fiduciary normally makes findings regarding whether the settlement meets the following requirements, among others:

- There is a genuine controversy involving the plan.
- The settlement terms, including the scope of the release of claims; the amount of cash and

the value of any non-cash assets received by the plan; and the amount of any attorney's fee award or any other sums to be paid from the recovery, are reasonable in light of the plan's likelihood of full recovery, the risks and costs of litigation, and the value of claims foregone.

- The terms and conditions of the transaction are no less favorable to the plan than comparable arms-length terms and conditions that would have been agreed to by unrelated parties under similar circumstances.
- The transaction is not part of an agreement, arrangement, or understanding designed to benefit a party in interest.
- Any extension of credit by the plan to a party in interest in connection with the settlement of a legal or equitable claim against the party in interest is on terms that are reasonable, taking into consideration the creditworthiness of the party in interest and the time value of money.

Special Rules for Non-Cash Consideration

PTE 2003-39 sets out additional requirements for settlements involving either (i) "non-cash assets," which may include employer securities and written promises of future employer contributions, and/or (ii) "enhancements," defined as a written agreement to adopt future plan amendments or provide additional employee benefits or corporate reforms.

One of these additional requirements specifically involves the authorizing fiduciary, and another involves the authorizing fiduciary or another independent fiduciary:

- The authorizing fiduciary must determine that an all cash settlement is either not feasible, or is less beneficial to the participants and beneficiaries than accepting all or part of the settlement in non-cash assets and/or enhancements.
- The authorizing fiduciary, or another independent fiduciary, must act on behalf of the plan and its participants and beneficiaries for all purposes related to any property, including employer securities as defined by section 407(d)(1) of the Act, received by the plan from the employer as part of the settlement. This role continues as long as the plan holds the property. The authorizing fiduciary or another independent fiduciary has sole responsibility relating to the acquisition, holding, disposition, ongoing management, and where appropriate, exercise of all ownership rights, including the right to vote securities, unless the plan is a participant-directed individual account plan and the authorizing fiduciary or another independent fiduciary allows the participants and beneficiaries to exercise control over the securities allocated to their accounts.