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New ERISA Fiduciary Concern When Employer Stock Offered as 401(k) Plan Investment Option

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Publicly-traded corporations that offer an employer stock fund as an investment option in their 401(k) plan have an obligation to furnish participants with both a summary plan description ("SPD") as required by **ERISA**, and a prospectus, as required by the Securities Act of 1933. For reasons of convenience and consistency, it has become a common practice of plan sponsors to combine the SPD and prospectus into a single document. As a result, certain SEC filings made by the plan sponsor (such as the plan sponsor's latest Annual Report filed pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934) that are required by the securities laws to be incorporated by reference in the prospectus are incorporated by reference in the combined SPD/prospectus. Two recent U.S. appellate court cases address potential ERISA fiduciary concerns that may arise if incorrect or misleading SEC filings are incorporated into an SPD.

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Dudenhoefer and Glaxosmithkline Cases

In the Sixth Circuit case of ***Dudenhoefer v. Fifth Third Bancorp***, the plaintiffs claimed that the defendants breached their fiduciary duty to the participants by failing to provide them with accurate information about the value of the bank's stock. This alleged breach resulted from the incorporation of misleading SEC filings into the plan's SPD. In overturning the district court's grant of the defendant's motion to dismiss, the Sixth Circuit stated that the plan administrator had exercised discretion in selecting the information to convey in the SPD, and that incorporation of the SEC filings into the SPD was, therefore, a fiduciary act. Thus, the court ruled that the complaint alleging misleading statements in the incorporated SEC filings stated a plausible claim for breach of fiduciary duty under ERISA.

However, in another recent case, the Court of Appeals for the Second Circuit upheld the lower court's dismissal of a similar claim. In ***In re Glaxosmithkline ERISA Litigation***, the Second Circuit held that the SEC filings were not made by the employer in its capacity as a plan fiduciary and thus were not "actionable as misstatements under ERISA." The court also found that the incorporation of the SEC filings in the SPD did not give rise to a claim for fiduciary breach in the absence of allegations that the plan administrators intentionally or knowingly made misleading statements by virtue of such incorporation.

Ramifications for Plan Fiduciaries

Plan sponsors offering employer stock funds should evaluate whether they should separate the SPD/prospectus into two documents. The Dudenhoefer decision increases the risk that plan fiduciaries may be held responsible for a breach of fiduciary duty in the event statements in the SEC filings (that are incorporated by reference in the SPD) are found to be misleading or incorrect. Separating these documents increases the likelihood that a court would view the SEC filings as distinct from an ERISA document. This is important because it helps to protect plan fiduciaries from a claim of breach of fiduciary duty with respect to any misstatement in an SEC filing because the SEC filings would be incorporated in a separate prospectus (a document for which the plan fiduciaries are typically not responsible). The reduced risk appears to outweigh the administrative benefits of combining the documents.

In lieu of creating two separate stand-alone documents, employers may wish to consider incorporating the SPD into the prospectus by reference. Many provisions required to be included in the prospectus – such as descriptions of plan eligibility requirements and plan distribution provisions – are also required by ERISA to be included in the SPD. Consequently, the potential ERISA fiduciary problem may be mitigated simply by preparing a separate prospectus containing certain required securities law provisions, including the incorporation by reference of potentially problematic SEC filings, that are not required to be included in an SPD. If this approach is taken, however, the prospectus must state that the SPD is incorporated by reference in the prospectus, and the SPD must continue to include the legend stating that it constitutes part of a prospectus. This approach reduces the risk of potential inconsistencies between the documents and insures that, by incorporation of the SPD into the prospectus, the prospectus contains all provisions required by the securities laws. Employers should note that regardless of whether the prospectus is combined with the SPD or is separate, it is never necessary to file the prospectus for an employee benefit plan registered on a Form S-8 with the SEC.

Given the differences in the approaches of the Sixth Circuit and the Second Circuit, employers may also wish to consider the location of employees who will receive the communications. While some practitioners expect that the Supreme Court will eventually address this issue, the circuits are currently split on the issue of fiduciary liability arising from incorporated SEC filings. Employers in the Sixth Circuit (Kentucky, Michigan, Ohio and Tennessee) may wish to make additional efforts to separate their SPD from an employer stock prospectus, while employers in the Second Circuit (Connecticut, New York and Vermont) might find it more advantageous to combine the documents given that circuit's relatively higher protections against fiduciary liability resulting from such communications.

Although *Dudenhoefer* has raised concerns for ERISA fiduciaries, employers can mitigate their exposure by separating fiduciary communications to plan participants from SEC filings. Employers should evaluate whether doing so makes sense for their particular situation.

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