

Client Alert

May 10, 2013

A recent court decision in a California case has caused some additional thinking on the scope of enforceable indemnification arrangements for ESOP trustees and ESOP committee members. We believe this is a good time for our clients to review the terms of their arrangements and determine if modifications are needed to keep these agreements in force.

Background

Many ESOP-owned companies have agreed to indemnify against liability the individuals or institutions that serve as either the trustee of the ESOP or as a member of a fiduciary ESOP committee. The terms (and scope) of the indemnification commitments are usually found in the ESOP plan document, and the trust agreement. If the ESOP employs an institutional or independent trustee, the trustee's engagement letter will usually have an indemnification provision as well.

Typically, these arrangements have provided that the company will indemnify the fiduciary for all losses, damages and expenses it may incur as a result of serving as a fiduciary; however, if the loss, damage or expense occurs as a result of the "gross negligence or willful misconduct" of the fiduciary, then the company is not liable to assist the fiduciary. This language leaves open the possibility that a fiduciary who is guilty of breaching its fiduciary duties could still enjoy the benefits of the indemnification commitment so long as it can show that the breach was not the result of its "gross negligence" or "willful misconduct."

ERISA Requirements

Section 410(a) of ERISA provides that "*any provision in an agreement or instrument which purports to relieve a fiduciary from responsibility or liability for any responsibility, obligation, or duty under [ERISA] shall be void as against public policy.*" In 1975, the Department of Labor published guidance to the effect that an indemnification of fiduciaries is permissible under Section 410(a) as it functions in the same manner as insurance.

Recent Case Law

In a 2009 decision, *Johnson v. Couturier*, (2009, CA9) 572 F.3d 1067, the 9th Circuit questioned the enforceability of indemnification agreements between ESOP plan sponsors and ESOP fiduciaries. In a subsequent lower court decision, *Fernandez v. K-M Industries Holding Co., Inc.*, a district court within the 9th Circuit extended the *Couturier* decision well beyond the scope of the 9th Circuit's holding. In the most recent case in the 9th Circuit to address the issues, *Hall v. GreatBanc Trust Company*, the lower court upheld the enforceability of an indemnification agreement between an ESOP trustee and the ESOP plan sponsor. We believe the court found the arrangement enforceable in large part because the indemnification agreement did not cover the Trustee in the event the Trustee was found by an unappealable court decision to have breached its ERISA fiduciary duties. We are concerned that the court would have found the arrangement in violation of ERISA if it included an indemnification for breach of ERISA fiduciary duty.

Actions to Consider

We recommend ESOP companies take the following steps:

1. Review with us the ESOP plan document and trust agreement to determine the current standards the fiduciaries must meet in order to have the benefit of the indemnification.
2. If the ESOP employs an outside trustee, review with us the trustee's engagement letter to understand any separate indemnification provisions.
3. Determine if amendments are necessary.
4. Review any ERISA fiduciary liability policies to determine if appropriate coverage is provided in light of changing positions on indemnification. We would recommend specifically determining whether the policy: (i) covers ERISA fiduciary liability (different from bonding) (ii) contains any ESOP exclusions, (iii) excludes ERISA or tax penalties or breach of fiduciary duty, and (iv) appropriately advances legal fees.
5. If there is no fiduciary liability insurance, consider a purchase.

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