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PRACTICAL CONSIDERATIONS IN DRAFTING AN INDEMNIFICATIONAGREEMENT FOR AN ERISA RETIREMENT PLAN FIDUCIARY

By Anthony L. Scialabba, Esq.

A retirement plan fiduciary can be held personally liable for a violation of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), under Section 409(a) of ERISA. Thus, when a retirement plan fiduciary is represented, he or she should be made into an "onion" and provided with as many layers of protection as possible from liability in connection with lawsuits initiated under ERISA. This article will discuss the practical considerations involved in drafting an indemnification agreement to protect a retirement plan fiduciary from ERISA liability. In this regard, a "plan fiduciary" shall refer to an individual who is an employee of a business or tax-exempt entity and serves as a fiduciary with respect to a retirement plan. (This is as opposed to, for

Terry Abbonizio Joins RetireWell Administrators, Inc.

RetireWell Administrators, Inc. is pleased to announce Terry Abbonizio has joined the firm as Vice President of Operations. In this role, Terry will oversee day to day operations, client services and the growth of relationships with our many different clients and partners. Terry brings 30 plus years of experience in the retirement industry with expertise in compliance, service, and operational efficiencies. Terry's work history includes leadership positions with United Retirement Plan Consultants, Professional Capital Services and Ascensus.

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example, an investment advisory firm which provides fiduciary services to a retirement plan.)

I. BACKGROUND

The "seminal" rules for the conduct of a fiduciary in connection with a retirement plan are generally found in Sections 404(a)(1) and 406 of ERISA. In general, a fiduciary must operate a retirement plan for the exclusive benefit of participants and beneficiaries under Section 404(a)(1)(A). In addition, a fiduciary must operate a retirement plan in a prudent manner under Section 404(a)(1)(B) of ERISA. A fiduciary must also diversify plan assets unless it is clearly prudent not to do so under Section 404(a)(1)(C) of ERISA. Finally, a fiduciary must operate a retirement plan in accordance with its terms under Section 404(a)(1)(D) of ERISA.

An additional set of rules under ERISA furthers the goal of operating a retirement plan for the exclusive benefit of participants and beneficiaries. These requirements are known as the "prohibited transaction" rules under Section 406 of ERISA. Under these requirements, a fiduciary cannot permit certain transactions to occur with respect to a retirement plan, including, but not limited to, "self-dealing" acts.

As mentioned above, if a fiduciary runs afoul of the "fiduciary" rules under ERISA, he or she can be sued in his or her personal capacity under Section 409(a) of ERISA. From a fiduciary's perspective, this makes protection from ERISA liability a personally important topic.

The first thing that must be done to protect a fiduciary of a retirement plan from ERISA liability is to determine who is a fiduciary. In this regard, Section 3(21)(A) of ERISA generally provides that a fiduciary is anyone who has any discretionary authority or control over the disposition or management of a retirement plan or its assets. Thus, if a person can amend a plan or pick and choose plan investments or investment providers, he or she will be an ERISA fiduciary. For example, a Chief Financial Officer or a Head of Human Resources, either of whom is not an owner of a company, may make decisions regarding plan amendments or investments with respect to a retirement plan that will establish that person in that office as an ERISA fiduciary.

Frequently, a person will be a fiduciary with respect to a retirement plan without even knowing it. In this regard, many times, an employee, even a corporate officer, is unaware that he or she is a fiduciary because that person generally is unaware as to who could be a fiduciary with respect to a plan. For example, an employee of a company may be under the mistaken belief that only the owner of the company could be a fiduciary.

In addition to being an ERISA fiduciary because he or she has certain authority or control, a particular individual by the very nature of his or her title will be a fiduciary. In this regard, a trustee or an administrator of a retirement plan will be a fiduciary by the functions he or she performs in the employee's position pursuant to Section 2509.75-8 D-3 of the Department of Labor Regulations. Thus, with respect to this type of individual, there is generally no need to have a determination as to whether the person is performing the requisite acts that would make him or her a fiduciary.

An example of how an individual can be held to the status of a fiduciary of a retirement plan by virtue of his or her title may be found in the Fifth Circuit Court of Appeals decision in Donovan v. Mercer, 747 F.2d 304, 307 – 308 (5th Cir. 1984). In that case, an individual repeatedly signed documents which identified her as a trustee or an administrator of a retirement plan. She claimed that she was not appointed as a trustee of the plan and that any signatures on documents as trustee or plan administrator were merely a clerical error. Thus, she argued that merely signing documents as a trustee or administrator did not necessarily cause her to become a fiduciary under the ERISA, but the court said her state of mind was irrelevant because

Congress intended "fiduciary" to be construed broadly. Consequently, in finding that a defendant was acting as a fiduciary, the circuit court remarked: "if it talks like a duck . . . and walks like a duck . . . , it is a duck". Donovan v. Mercer, 747 F.2d 304, 308, 309 (5th Cir. 1984).

II. INDEMNIFICATION AGREEMENT AS A FIDUCIARY PROTECTION

Once the determination of who is a fiduciary with respect to a plan has been made, the next step is to determine how to protect the fiduciary from personal liability exposure. Different approaches can be taken to protect a fiduciary, and, the more layers of protection that can be provided the better (the "onion" metaphor does have a place in this article and on a Fenway Frank). One of the best ways to protect a fiduciary liability is through the utilization of an indemnification agreement.

Section 410(a) of ERISA prohibits any arrangement which purports to relieve a fiduciary from responsibility or liability for any responsibility, obligation or duty under ERISA's fiduciary rules. However, Section 410(b) provides that ERISA does not bar the purchase of liability insurance by an employer.

The Department of Labor ("DOL") has interpreted section 410(b) to allow indemnification of fiduciaries, provided that the agreement does not relieve a fiduciary of responsibility or liability under ERISA according to Section 2509.75-4 of the Department of Labor Regulations. Moreover, the DOL states that an indemnification provision is valid if it "merely permit[s] another party to satisfy any liability incurred by the fiduciary in the same manner as insurance." However, this DOL provision does not extend to indemnification of a fiduciary by the ERISA plan itself. This is because the DOL interprets Section 410(a) as rendering void any arrangement for indemnification of a fiduciary of an employee benefit plan by the plan. Johnson v. Couturier, 572 F.3d 1067, 1080 (9th Cir. 2009). The DOL has stated that "[s]uch an arrangement would have the same result as an exculpatory clause, in that it would, in effect, relieve the fiduciary of responsibility and liability to the plan by abrogating the plan's right to recovery from the fiduciary for breaches of fiduciary obligations" under Section 2509.75-4. Thus, an employer can provide a fiduciary with an agreement which states that if there is a claim made in connection with his or her acts with respect to a retirement plan, then the employer that sponsors the plan will pay for any damages, attorney fees or other costs incurred with respect to such suit.

An indemnification agreement does not exempt a fiduciary from ERISA liability. If a lawsuit occurs against a fiduciary, and he or she loses, the fiduciary is still liable to pay damages. However, the payment in connection with these damages is shared either all or in part with the employer which sponsors the plan. Thus, the indemnification agreement acts similar to how an insurance policy operates.

The concept that an indemnification agreement does not exempt a fiduciary from ERISA liability also means that Act's equitable remedies still apply to a breaching fiduciary. For example, if a fiduciary takes actions which would constitute a breach of ERISA, either the Department of Labor or a participant can still enjoin the fiduciary from continuing such actions under Section 502(a) of ERISA.

An indemnification agreement may be helpful for an employee, a corporate director, or a corporate shareholder who is a fiduciary of a retirement plan. For example, assume that a physician practice has 50 doctors each of whom has a two percent shareholder interest and 150-member staff. Further assume that three doctors are the trustees of a 401(k) plan sponsored by the practice. In this case, an indemnification agreement covering the three trustee/physicians would work well because the six percent shareholder interest that they collectively own does not make them the "alter ego" of the practice. Therefore, a financial "hit" to the practice, like an ERISA lawsuit, would be felt evenly by all of the physicians. As a result, an indemnification agreement would provide

significant protection for the indemnified physicians.

An employer may also create some good-will with an employee who is a plan fiduciary by providing an indemnification agreement to protect the employee. This may also help an employer because an employee or a small, minority shareholder who determines that he or she is a fiduciary with respect to a plan may not wish to take on the responsibility's attendant thereto if he or she lacks fiduciary protection.

Although an indemnification agreement may be good for an employee or a small, minority shareholder, a majority owner of an entity and the company itself are generally the same as far as the liability of paying for the costs of an ERISA claim are concerned. Consequently, the utilization of an indemnification agreement for such a person is usually not helpful in reducing liability exposure. For example, assume a law firm has ten attorneys with only one owner and 20 staff employees. Further assume that the owner/attorney is the trustee of a 401(k) plan sponsored by the firm. In this case, an indemnification agreement covering the owner/attorney would not be helpful because he or she is the "alter ego" of the practice. Therefore, the cost of an ERISA lawsuit would generally be felt only by him or her. Thus, an indemnification agreement would not provide any significant protection for the indemnified attorney.

Finally, in terms of legal costs for providing an indemnification agreement to protect a fiduciary from ERISA liability, such an agreement is usually considered to be "off-the-shelf" work. This is because either an almost identical document or similar agreement can be used by the attorney again and again. The legal costs involved generally should not be prohibitive.

III. PRACTICAL CONSIDERATIONS WHEN DRAFTING AN INDEMNIFICATION AGREEMENT

A. Drafting Considerations

With regard to the practical considerations involved when drafting an indemnification agreement, the document that will provide for such protection to a plan fiduciary is important and must be structured carefully. In this regard, it can appear in a corporate resolution or company consent, which is fairly common, the plan document, the trust agreement for the plan or an engagement agreement. Perhaps the most important issue is that the indemnification be reduced to a writing.

It is also important to understand the exposure for which a plan fiduciary is being indemnified. Typically, an indemnification agreement protects a fiduciary from any and all costs, damages, expenses and liabilities incurred by or imposed upon the fiduciary against claims made against the fiduciary or which the fiduciary may be involved by reason functions or position of the fiduciary with respect to a retirement plan. In addition, the fiduciary may be entitled to be paid the expense of defending any such proceedings. This could include attorney and court costs. Moreover, an employer may also wish to provide for an advancement of expenses to a plan fiduciary with regard to any of these matters.

An employer who provides a fiduciary of a retirement plan with an indemnification agreement to protect the fiduciary from ERISA liability typically provides that the agreement does not protect a fiduciary against any willful, wanton, criminal, or grossly negligent acts or acts which constitute gross misconduct or violate the anti-exculpatory rule in Section 410(a) of ERISA committed by the fiduciary. An employer should also decide who has the burden of proving any of the acts which preclude or require indemnification and/or advancement of expenses. In addition, an employer may wish to exclude any claims, causes and actions initiated by a plan fiduciary against a plan or the plan sponsor. Furthermore, there are certain instances where an employer may wish to

be reimbursed for costs expended in connection with proceedings where a plan fiduciary defends his or her claim for indemnification or advancement of expenses and loses.

With respect to other "employer" drafting considerations in connection with an indemnification agreement, an employer should decide whether it will place a limit on the aggregate indemnification or reimbursement for the same claims or expenses. For example, an employer could state in the indemnification agreement that the indemnitee shall be able to obtain aggregate indemnification or reimbursement for the same claims or expenses in an amount not in excess of 100% of such claims or expenses. In addition, the employer could provide for an "ordering" with respect to claims and expenses. For example, an indemnification agreement could provide that a fiduciary is responsible for the first $50,000 in attorney fees to defend an ERISA lawsuit and the employer must pay for the attorney expenses in excess of such amount.

With regard to the rights of a plan fiduciary in connection with an indemnification agreement, even though an employer may exclude certain acts or claims of the indemnitee, a plan fiduciary may still wish to have the ability to enforce the terms of the indemnification agreement, make cross claims, counterclaims, and requests for declaratory relief or affirmative defenses. In addition, an indemnitee may wish to have the ability to bring an action against an employer if a reasonable claim for indemnification or a claim for the advancement of expenses is not paid in full by the employer within a certain period of time from when the employer receives notice regarding the claim from the indemnitee and to be reimbursed for the costs for such a claim.

An employer may allow the indemnitee the flexibility to have the ability to settle any matter covered in the indemnification agreement. However, this power could be limited to claims that do not involve, for example, alleged gross misconduct or criminal behavior.

An indemnitee may also wish to have the indemnification agreement make clear that any rights to indemnification or the advancement of expenses conferred under the agreement would not be exclusive of any other right which the indemnitee may have or later acquire under other corporate laws (e.g., any statue, provision of a certificate of incorporation, by-law, agreement, vote of stockholders or disinterested directors or otherwise).

There are also legal constraints involving how a plan fiduciary can be indemnified. For example, an argument may be made that an employer is precluded from indemnifying a plan fiduciary when the agreement is conditioned on the duties of the fiduciary and carrying out those duties, like following instructions provided to the fiduciary without exercising independent judgment. A good source for this discussion is L. Golumbic, "Who May Sue You and Why: How to Reduce Your ERISA Risks, and the Role of Fiduciary Liability Insurance" a Chubb Special Report (produced by the Goom Law Group Chartered) (2017).

A claim can be made that such language in an indemnification agreement could cause a fiduciary to not question whether the instructions that they were given were in the best interests of the plan and plan participants because of the indemnification protection. The agreement should allow a fiduciary to exercise independent judgment.

Another legal constraint involving the ability to indemnify plan fiduciaries concerns public policy. Specifically, the Ninth Circuit Court of Appeals in IT Corp. v. Gen. Am. Life Ins. Co., 107 F.3d 1415, 1418 (9th Cir. 1997) and other courts have suggested that public policy underlying the "anti-exculpatory" provision of ERISA section 401(a) may preclude indemnity that absolves fiduciaries of responsibility for their breaches of duty.

B. Other Considerations

There is an overall issue to consider when an indemnification agreement is being offered. Specifically, even when an indemnification is not prohibited by applicable law and an employer may be willing to indemnify a plan fiduciary for the

claims and costs, an employer may not be financially able to indemnify the fiduciary. There is a risk that the employer may not have sufficient funds or available funds to do so. The employer could become bankrupt or otherwise insolvent. These issues can often arise, especially during periods of economic downturns.

There are also special considerations for indemnification involving an Employee Stock Ownership Plan ("ESOP") fiduciary. Some courts have held that employers whose shares are owned by an ESOP are not permitted to indemnify the fiduciaries of the ESOP because this would violate the anti-exculpatory cause of section 410(a) of ERISA as some courts have pointed out, Johnson V. Couturier, 572 F. 3d 1067 (9th Cir. 2009); Fernandez et. A. v. K-M Industries Holding Co., 646 F. Supp. 2d 1150 (N.D. Cal. 2009). The position of the courts is that the value of the employer stock held by the ESOP is ultimately reliant on the value of the employer. Any liabilities of the employer (e.g., indemnification liabilities) abate the value of the employer. This, in turn, reduces the value of the ESOP shares. It is important to note that at least one court has not followed this position, Harris v. GreatBanc Trust Co., No. EDCV12-1648-R (DTBx), 2013 WL 1136558 (C.D. Cal. March 15, 2013).

Finally, state corporate laws may also prevent or reduce an employer's ability to indemnify plan fiduciaries. A good source for this discussion is R. Barker and K. O'Brien, "Double Indemnity: Does Your Plan's Fiduciary Indemnification Clause Protect Your Plan Administrator?" Benefits Law Journal, a Panel Publication, Aspen Publishers, Inc. (2003).

IV. CONCLUSION

There is a fundamental issue of fairness in employer/employee relations. Specifically, most people would agree that it seems fair to indemnify an employee who is serving as a retirement plan fiduciary. The reason why is because most, if not all, major decisions that concern a retirement plan are ultimately made by the shareholders or partners of the company or the board of directors of the entity (as opposed to the plan fiduciary), and the entity is in a better position financially (again, as opposed to the plan fiduciary) to pay for ERISA claims and costs.

An indemnification agreement is relatively inexpensive to draft, and it is an effective method of protecting a fiduciary of a retirement plan from ERISA liability. An employer who sponsors a retirement plan should consider using such an agreement to protect a plan fiduciary, particularly when the fiduciary is an employee of the company performing functions as the position requires.

Anthony L. Scialabba, Esq., is the Managing Member at The Law Firm of Anthony L. Scialabba, LLC. In addition, he serves as the President and the Chief Executive Officer of RetireWell Administrators, Inc., a retirement and executive compensation administration firm. Mr. Scialabba has over 30 years of experience in employee benefits law and over 20 years of experience in third-party plan administration and has published 70 articles on employee benefit topics.

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