

Are SEC Filings Subject to ERISA Fiduciary Standards?

Introduction

When defined contribution pension plans invest in company stock, a number of federal courts have held that plan fiduciaries may be liable under ERISA for misrepresentations (or omissions) contained in the sponsoring company's SEC filings. This result effectively creates a companion ERISA case for most federal securities fraud actions. Until recently, these holdings were limited to cases where the Summary Plan Description ("SPD") expressly incorporated by reference the sponsor's SEC filings. In a substantial expansion of this theory of liability, however, the District of New Jersey has now held that SEC filings can be subject to ERISA fiduciary obligations, even if the SPD does not expressly incorporate such filings by reference. *In re Schering-Plough Corp. ERISA Litig.*, No. 03-1204 (D.N.J. Aug. 15, 2007).

When misrepresentation claims are made under ERISA, a threshold legal question is whether the alleged misrepresentations were made in a fiduciary capacity. *Pegram v. Herdrich*, 530 U.S. 211, 226 (2000) ("[i]n every case charging breach of ERISA fiduciary duty . . . the threshold question is . . . whether that person was acting as a fiduciary (that is, was performing a fiduciary function) when taking the action subject to complaint."). ERISA, thus, permits plan fiduciaries to wear "two hats" — one for actions in a fiduciary capacity and one for actions in a corporate capacity. See *Pegram*, 530 U.S. at 225 (noting that ERISA fiduciaries are permitted to have financial interests adverse to plan participants and to take actions harmful to plan participants when acting as employers); see also 29 U.S.C. § 1108(c)(3) (expressly authorizing the appointment of officers or employees of the plan sponsor to serve as fiduciaries).

Accordingly, fiduciaries faced with such misrepresentation claims have argued that a company's SEC filings are not statements made in a fiduciary capacity, and therefore cannot be the basis for an ERISA breach of fiduciary duty claim. There is substantial uncertainty, however, as to when statements about the plan sponsor are made in a fiduciary capacity.

The Supreme Court has held that communications about a company itself, as opposed to the plan or its benefits, can be subject to fiduciary requirements, but only where there is some connection between the communications and benefits. *Varity Corp. v. Howe*, 516 U.S. 489, 504 (1996). *Varity*, however, leaves open the question of the type of nexus that is necessary between communications and benefits in order to implicate ERISA's fiduciary requirements.

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The Securities Requirements

The Securities Act of 1933 (“Securities Act”) requires issuers of certain securities to file registration statements. 15 U.S.C. § 77c. Form S-8 is the statement that covers “securities to be offered to employees pursuant to employee benefit plans.” 17 C.F.R. § 239.16(b) (a). This form is used to register: (1) securities that an employer issues to its own employees or employees of a parent or subsidiary; and (2) interests in plans that offer such securities. *Id.* A registrant is required to incorporate certain prior SEC filings by reference in a Form S-8. See Form S-8 at 8.

Section 10(a) of the Securities Act requires issuers of certain securities to prepare prospectuses. 15 U.S.C. § 77j(a). Special rules apply if a Form S-8 is used to register the securities. For example, a prospectus need not be filed with the SEC and the registrant may rely on plan documents such as an SPD to serve as the prospectus. See SEC Release No. 280924 *5-6 (June 6, 1990). A Section 10(a) prospectus must incorporate by reference the same SEC filings that must be incorporated by reference in a Form S-8. 17 C.F.R. § 230.428.

Given these rules, it is a fairly common practice for publicly traded companies with 401(k) plans that invest in employer securities to use the plan’s SPD — which must be distributed under ERISA — as the prospectus for stock issued through the plan. Thus, the SPD serves as the prospectus and incorporates by reference the company’s other securities filings. Whether this incorporation by reference is a sufficient connection to benefits to make all SEC filings fiduciary communications remains a contentious issue.

The Prior District Court Decisions

WorldCom was the first case to find a fiduciary disclosure obligation with respect to public securities filings. *In re WorldCom, Inc. ERISA Litig.*, 263 F.Supp.2d 745 (S.D.N.Y. 2003). The *WorldCom* court found that a corporate officer with authority to monitor other fiduciaries could be held liable for failing to disclose to “investing fiduciaries” information he knew or should have known about the precarious financial condition of WorldCom. *WorldCom*, 263 F.Supp.2d at 765 (“When a corporate insider puts on his ERISA hat, he is not assumed to have forgotten adverse information he may have acquired while acting in his corporate capacity.”) Further, because SEC filings were incorporated by reference into the SPD, allegedly false information about the stock in such filings could serve as the basis for a fiduciary breach claim, because the SPD was deemed to be a communication to participants by the plan’s fiduciaries in a fiduciary capacity. *Id.*

Since the *Worldcom* decision, other district courts have handed down similar rulings. *In re Sprint Corp. ERISA Lit.*, 388 F.Supp.2d 1207, 1226 (D.Kan. 2004) (“Plaintiffs point out that their complaint alleges these SEC filings were incorporated by reference into the SPDs and prospectuses and that Defendants were therefore acting in their ERISA fiduciary capacities when they made those representations. The Court agrees.”); see also *In re AEP ERISA Litig.*, 327 F.Supp.2d 812, 825 (S.D. Ohio 2004) (refusing to dismiss complaint where SPD incorporated by reference allegedly misleading SEC filings); *In re JDS Uniphase Corp. ERISA Litig.*, No. 03-4743, 2005 U.S. Dist. LEXIS 17503, at *37-38 (N.D. Cal. July 14, 2005) (“Courts have held that dismissal at this stage is

inappropriate where SEC filings are incorporated by reference into documents provided to Plan participants”); *In re Honeywell Int’l ERISA Litig.*, No. 03-1214, 2004 U.S. Dist. LEXIS 21585, at *29 (D.N.J. Sept. 14, 2004) (by incorporating SEC filings into the SPD by reference, Defendants “took responsibility for the truthfulness of the SEC disclosures that had been filed previously” and “also took on a duty to correct later SEC disclosures to the extent that they knew...that those statements were false”).

In Re Schering-Plough Corp. ERISA Litigation

In the recent *Schering-Plough* decision the defendants moved to dismiss plaintiff’s disclosure allegations, which were based on statements contained in two S-8 Forms and the plan’s prospectus, as well as the SPD. Defendants argued that because the S-8 Forms and the plan’s prospectuses are required by federal securities laws, rather than ERISA, the act of preparing and distributing these documents could not have been an ERISA fiduciary action. They also argued that the SPD did not itself expressly incorporate any of the public filings that formed the basis of plaintiff’s misrepresentation claims.

The court noted that other courts have rejected attempts by ERISA plaintiffs to impose liability for statements made in communications required *only* by federal securities laws, but not required by ERISA. See e.g., *In re RCN Litig.*, No. 04-5068, 2006 U.S. Dist. LEXIS 1212930, at *38 (D.N.J. Mar. 21, 2006) (statements made in various press releases and SEC filings were not actionable under ERISA because none of the “statements, regardless of truth or falsity, were made in a fiduciary capacity regarding the Plan”); *In re Reliant Energy ERISA Litig.*, No. 02-2051, 2006 U.S. Dist. LEXIS 3181, at *12 (S.D. Tex. Jan. 18, 2006) (Misstatements in an S-8 Form were not actionable under ERISA because the employer had “no discretion whether to file the Form S-8” and because the company took no action other than that required by the SEC for issuers of stock); *In re Calpine Corp. ERISA Litig.*, No. 03-1685, 2005 U.S. Dist. LEXIS 34452 at *28 (N.D. Cal. Dec. 5, 2005) (declaring that “unless plaintiff can plead and prove that the SEC filings were disseminated to the Plan participants in a way that was meaningfully related to the Plan itself, the mere fact that Calpine filed such documents is not enough to establish ERISA liability”); *In re Tyco Int’l Ltd. MDL*, No. 02-1335, 2004 U.S. Dist. LEXIS 24272, at *22 (D.N.H. Dec. 2, 2004) (alleged misstatements in Form S-8s and § 10(a) prospectuses “must be enforced under the securities laws rather than ERISA”). Following the reasoning of these courts, the *Schering-Plough* court held that the two S-8 Forms and prospectus at issue were required only by federal securities laws, not by ERISA, and thus could not themselves form the basis of an ERISA misrepresentation claim.

However, the *Schering-Plough* court also held that unlike the S-8 Forms and the prospectus, ERISA does require plan administrators to periodically furnish an SPD, and statements in the SPD can form the basis of an ERISA misrepresentation claim. The court rejected defendant’s contention that the SPD did not incorporate by reference any of the SEC filings alleged to have contained misrepresentations. The SPD disclosed to participants that they could obtain copies of prospectuses and financial reports upon request, but did not contain any language expressly incorporating SEC filings by reference. Nonetheless, the court held that the references to securities filings “impliedly incorporated by reference in the prospectus into the SPD.” *In re Schering-Plough Corp. ERISA Litig.*,

No. 03-1204, at 10. According to the court, this “brought any statements made in the prospectus, or incorporated therein, into ERISA’s crosshairs.” *Id.* (citing *In re Dynegy, Inc. ERISA Litig.*, 309 F.Supp.2d 861, 879 (S.D.Tex. 2004) (“Plaintiff’s allegations that defendants distributed material that expressly ‘encouraged’ Plan participants to ‘carefully review’ *Dynegy’s* SEC filings, which they do not dispute materially misrepresented the Company’s financial status, sufficiently alleges that...defendants breached the fiduciary duty to speak truthfully to Plan participants.”)).

Conclusion

The *Schering-Plough* court’s holding is of substantial concern to employers who offer employer stock through defined contribution plans. If other courts follow this reasoning, even minor references to SEC filings in SPDs or (possibly) other participant communications may be enough to subject the sponsor’s securities filings to ERISA fiduciary obligations. The majority of courts still refuse to impose ERISA duties and liability with regard to public filings that are not incorporated by reference in the SPD. Therefore, plan sponsors should still consider separating the prospectus from the SPD and removing any language in the SPD that incorporates by reference any securities filings into the SPD. Unfortunately, however, even that precaution may not be sufficient to protect plan sponsors from ERISA suits based on alleged errors or omissions in their public filings, if they have employee stock in their defined contribution plans. Although we believe *Schering-Plough* was wrongly decided, it is certainly possible other courts will follow its lead.

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