ROBINSON & COLE LLP
Employee Benefits & Compensation

District Court Refuses to Dismiss Enron Participants' Claims

Participants in Enron's retirement plans who suffered losses to their accounts as a result of the collapse of Enron filed claims against many parties, including Enron, members of the Plan Administrative Committee, the officers and directors responsible for appointing members to the Administrative Committee, Arthur Andersen, Enron's auditor, and Northern Trust, the bank serving as directed trustee of Enron's plans. The participants alleged that the defendants breached their fiduciary duties of assuring that plan funds were prudently invested and diversified, among other claims. The defendants filed a motion to dismiss these claims. In the first of what is likely to be many decisions released in this case, the court refused to dismiss most of the participants' claims. However, some of the non-fiduciary claims, such as the RICO claims and some of the state law claims, were dismissed.

The participants claimed that the fiduciaries of Enron's plans breached their fiduciary duties of loyalty and prudence based on their inducement of plan participants to invest in Enron stock when the fiduciaries knew the stock was over-valued. The participants also stated a claim for breach of fiduciary duty by the Administrative Committee by causing the Savings Plan to purchase and accept Enron's matching contributions in the form of Enron stock after the fiduciaries knew or should have known of the risk of such an investment in light of Enron's precarious financial circumstances. The terms of Enron's Savings Plan required Enron to provide the Administrative Committee with any information that the Committee determined to be necessary for the proper administration of the plan. The Savings Plan also stated that Enron was required to provide the trustee with such facts as deemed necessary for the trustee to carry out its duties under the plan. The participants claimed that Enron and the Compensation Committee of the Board of Directors breached their fiduciary duty to provide information necessary for plan administration because they did not provide the Administrative Committee with information concerning the actual financial condition of Enron. The participants' complaint alleges that the Administrative Committee breached its fiduciary duty by failing to investigate Enron's financial condition. The court found that members of the Administrative Committee and the Compensation Committee, as well as Enron, had a fiduciary duty not to materially mislead participants about Enron's financial conditions and the risk of investing in Enron stock. Based on these facts, the court found that the participants had stated claims against Enron and Committee members for breaching the duty of loyalty to Savings Plan and ESOP participants and the duty of care to act with the skill, prudence and diligence under the circumstances and refused to dismiss the claims.

Due to the extraordinary circumstances surrounding the decline in value of Enron stock during October, 2001, the previously scheduled blackout for investments in both the Savings Plan and the ESOP had the potential to detrimentally affect participants' accounts. The court found that the participants could proceed with their claim for breach of fiduciary duty by

Enron, Northern Trust and other fiduciaries for proceeding with the previously scheduled account blackout under these circumstances. The participants alleged that the blackout, which denied them access to their accounts, was an exercise of control over plan assets by Northern Trust. The court found that even if Northern Trust was acting as a directed trustee, it was still required to determine whether its directions were consistent with ERISA and it was required to disregard improper instructions provided by the Administrative Committee.

Although ERISA exempts certain defined contribution plans from the diversification requirement to the extent plan assets are invested in employer stock, the court found that Enron's Savings Plan document required diversification and thus imposed a contractual duty on fiduciaries to diversify plan investments. Although the plan stated that company matching contributions were to be made primarily in Enron stock, the court found that the participants stated a claim in their allegation that the Administrative Committee had an overriding fiduciary duty to monitor the prudence of Enron stock investments if the stock had become an imprudent investment.

The participants also alleged that the officers and directors of Enron responsible for appointing members to the Administrative Committee had breached their fiduciary duty. The court confirmed that a person who has the power to appoint a plan fiduciary has discretionary authority over the management of the plan and is a fiduciary.

The Federal Securities Law requires a corporate insider, because he owes a fiduciary duty to shareholders, to either disclose material nonpublic information publicly or abstain from trading his own shares for personal gain. The court rejected the assertion by Enron's officers and directors that they could not have followed both their duties under ERISA and under the Federal Securities Laws prohibiting insider trading. The court stated that they could have acted consistently with their duties under both laws by either disclosing to participants and to the public the nonpublic information regarding Enron's financial condition, or by ceasing to invest plan assets in Enron stock.

The participants also claimed that Arthur Andersen engaged in fraudulent accounting practices and committed malpractice in negligently performing its accounting duties and certifying the accuracy of financial statements that they should have known to be false and misleading. Although ERISA preempts most state law claims relating to an ERISA plan, the court found that ERISA did not preempt these professional negligence claims relating to Arthur Andersen's services.

This court decision does not dispose of the participants' claims, but allows the surviving claims to proceed to trial where the participants will be given the opportunity to present evidence establishing the facts necessary to prove the allegations.

Sarbanes-Oxley Compliance Does Not Require SEC Filings

The SEC and the Justice Department have determined that companies are not required to certify the accuracy of employee benefit plan reports on Form 11-K, Form 6-K or Form 8-K in order to comply with the new requirements under the Sarbanes-Oxley Act. Although a

formal announcement has not yet been made, SEC staff announced the decision at a corporate lawyers' conference in San Francisco last week and a formal announcement is expected shortly.

California Health Care Reform Bill Requires Employers to Provide Health Insurance to Employees

A new law in California requires employers to provide a minimum level of health insurance coverage to employees. If an employer does not provide health insurance satisfying the new law's requirements, the employer is required to pay into a pool that will be used to provide healthcare coverage to employees throughout the state.

Generally, ERISA preempts state laws relating to employee benefit plans and, as a result, states cannot regulate ERISA plans. Because this law directly impacts ERISA welfare benefit plans, it is likely that the law will be challenged on the grounds that it is preempted by ERISA. The new law does not become effective until 2006 for large employers and 2007 for employers of 20 to 49 employees. The expected court challenges should be resolved before that time.

Employer Compliance With New COBRA Regulations Not Required Until Mid-2004

In the June edition of Benefits E-News, we reported on the DOL's proposed COBRA regulations, which included a model initial participant notice and model COBRA election notice. The DOL recently announced that it expects to issue final regulations early in 2004 and that compliance with the final regulations will not be required for six months following the release of the final regulations. Accordingly, use of the two model notices is not required. However, plan sponsors may use the model notices contained in the proposed rules while awaiting final rules.