Case Law Developments for April 2013

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The Evolving Landscape of Trustee Indemnification By ESOP Companies --- Harris V. Greatbanc Trust Company

Seth D. Harris v. GreatBanc Trust Company, et. al.
2013 U.S. Dist LEXIS 43888,2013 WL 1136558 (C.D. CAL. Mar 15, 2013)

The Ninth Circuit Court of Appeals created a controversy in the ESOP community in 2009 with its decision in *Johnson v. Couturier,* 572 F.3d 1067 (9th Cir. 2009) dealing with the ability of an ESOP company to indemnify an ESOP trustee against losses, costs, damages and expenses, including attorneys' fees, and the advancement of fees and costs during the course of litigation. The Ninth Circuit voided the indemnification agreement by a 100% ESOP-owned company on the basis that such an agreement would cause plan assets to be improperly used to indemnify for a fiduciary breach. The *Couturier* decision cast uncertainty over a common engagement provision, although many experts argued that the decision should be applied narrowly because of the broad scope of the indemnification clause and the unique fact that the ESOP company had sold all its assets and held only cash (which would be distributed to the ESOP participants if not paid to the defendants by way of indemnification). On March 15, 2013, the District Court for the Central District of California agreed and issued an order that distinguished *Couturier,* thereby providing trustees and ESOP companies with valuable guidance for drafting indemnification provisions.

The *GreatBanc* decision involved a mature ESOP that owned 100% of Sierra Aluminum. The ESOP was formed in 2001, and in 2005 GreatBanc was appointed successor trustee. Sierra Aluminum entered into an engagement agreement with GreatBanc that provided indemnification in certain defined circumstances. Under the agreement, Sierra Aluminum agreed to indemnify GreatBanc (and its officers, directors, employees and agents --- collectively called the "Indemnitees") against any loss, cost, expense or damage, including attorney's fees (collectively called a "Loss"), resulting from a legal proceeding related in any way to the performance of services by the Indemnitees pursuant to the ESOP documents or the engagement agreement. Two additional terms of the provision were key to the Court's decision, and are important points for trustees and ESOP companies to consider when drafting an indemnification provision.

First, the engagement agreement provided that indemnification would not apply to the extent the Loss was held by a court of competent jurisdiction, in a final judgment from which no appeal could be taken, to have resulted from (i) gross negligence, (ii) willful misconduct, or (iii) a <u>violation or breach of any fiduciary duty imposed under ERISA</u>. Second, in order for the Indemnities to have their fees or expenses advanced in the litigation by the company, a reasonably satisfactory arrangement had to be made to ensure a repayment of such advancements in the event the Indemnitees were found not to be entitled to indemnification (i.e., they were held to have breached their fiduciary duty under ERISA).

The Department of Labor ("DOL") challenged the enforceability of the indemnification provision under ERISA Section 410(a) and argued that as a 100% ESOP-owned company, the indemnification would harm the value of the stock owned by the ESOP. ERISA Section 410(a) states that "any provision in an agreement or instrument which purports to relieve a fiduciary from responsibility or liability for any responsibility, obligation, <u>or duty</u> under this part shall be void as against public policy." The District Court ruled that the indemnification provision did not violate ERISA Section 410(a) because it expressly prohibited indemnification in the event a court held, in a non-appealable order, that the Indemnities had breached their fiduciary duties under ERISA. The Court distinguished *Couturier* on the basis that the *Couturier* indemnification agreement did not exclude indemnification for breach of fiduciary duty under ERISA.

The DOL pressed this ERISA Section 410(a) issue by arguing that the agreement's indemnification exclusion required a final court order, but it is conceivable that a trustee could circumvent this requirement by settling the case. In response, the Court noted that the DOL cited no legal authority to extend the reach of ERISA Section 410(a) to preclude advancement of defense costs in a fiduciary breach case because of the mere possibility the case could settle before a court could issue a non-appealable finding of breach of fiduciary duty (which was a requirement of the subject indemnification provision). The Court also noted that the DOL was the plaintiff in this case and could condition any settlement on terms of its choosing (such as restricting or prohibiting indemnification).

The DOL also argued that although the indemnification provision required the Indemnities to make reasonably satisfactory arrangements to repay advanced expenses, the agreement did not specify how that would occur. The Court rejected that argument and noted that the DOL may seek a bond to be posted to protect the ESOP company.

In the order, the Court noted that the *Couturier* case involved very unique facts, and suggested it should be limited to those narrow facts. The *Couturier* case involved a broad (i.e., pro-trustee) indemnification provision that lacked the breach of fiduciary duty exclusion found in the present case. Also, the company's assets in *Couturier* had been completely liquidated and the company's only assets were cash, which cash was sought to be used to indemnify the trustee. The present case involved a fully operational company.

The *GreatBanc* case provides important guidance to trustees and ESOP companies drafting indemnification provisions. First, at a minimum, the scope of indemnification should be limited to preclude indemnification if the trustee is found by a court to have breached its fiduciary duties under ERISA. Additional consideration may be given by the parties to address the concerns raised by the DOL that the trustee might avoid the indemnification exclusion by settling the case before a court could make a finding of a fiduciary breach. Second, if the indemnification provision provides for the advancement of fees and costs, the agreement should require the parties to agree on a reasonably satisfactory repayment mechanism if the indemnification is ultimately prohibited. Although the Court did not set aside the indemnification provision in this case because it did not specify "how" the repayment would be made or secured, the parties should consider this in drafting their agreements. The ESOP company and its board must act prudently to ensure the company is repaid if the trustee ultimately is required to do so. The ESOP company should evaluate the potential amount of indemnification and the financial ability of the trustee to repay any advance. Also, it is in the best interest of both parties to arrive at a reasonably satisfactory mechanism to ensure repayment rather than run the risk that the Court might impose an expensive alternative, such as a bond. Cash or surety bonds can be very expensive, so less expensive mechanisms should be pursued.

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The author reviewed this article with Committee Chair, Susan D. Lenczewski, Fafinski, Mark & Johnson, P.A., Minneapolis, MN.

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