

This month we consider several recent developments relating to evolving corporate and executive exposures in the U.S. While it may seem that exposures only move in one direction (up), we highlight recent examples that refute this assumption in the areas of employment disputes, ERISA litigation and corporate governance regulations.

TO BE OR NOT TO BE - THE ACTUAL EMPLOYER THAT IS

It seems like a simple concept: for a company to be a defendant in an employment action, it generally needs to be or have been the employer or potential employer. But it recently took a federal appeals court to finally decide that employees of a subsidiary are **not** employees of the subsidiary's parent company, despite an employee's belief to the contrary.¹ The worker in this case had sued the parent organization and some of its subsidiaries, alleging sexual harassment by a co-worker and an inadequate response by the employer.² In a refreshingly clear and direct holding, the court of appeals ruled that "we do not doubt that [the employee] may have thought [that the parent organization] was her employer, but her subjective belief alone is insufficient to create a triable issue of material fact," affirming a lower court's ruling that had dismissed the parent as a defendant in the employment litigation.

This decision will be of keen interest and some relief to organizations with centralized human resource and payroll functions. Part of the evidence produced by the plaintiff as to the identity of the employer included:

- A centralized HR department that had responded to the internal allegations at the subsidiary level of wrongful behavior in the workplace
- A company "Code of Business Conduct" established by the parent organization
- Centralized payroll (including W-2 issuance)³

FEES PLEASE! NO? NO WAY!

One major difference in how typical Directors & Officers (D&O) and Professional Liability (or E&O) litigation work – in contrast to ERISA fiduciary matters – is in the way plaintiffs' legal fees are



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addressed. In U.S. D&O and E&O litigation, plaintiffs' legal expenses are usually paid out of any award or settlement that the plaintiffs may receive, assuming they succeed with their claim. But the Employee Retirement Income Security Act (ERISA) sets out a different regime. Under ERISA, a court, may, in its discretion, award reasonable attorneys' fees and costs to either party. In legal actions involving delinquent contributions to a plan, when brought by a fiduciary, the court has no discretion but **must** award reasonable attorneys' fees and costs where the plaintiff prevails.⁴

EXAMPLE OF LEGAL FEES IN A D&O/E&O CLAIM A dispute results in a \$100 court award. Plaintiff's legal fees are generally paid out of the award. Assuming a 25% rate for legal fees, the plaintiffs' recovery is reduced to roughly \$75 or 75% of their award.

EXAMPLE OF LEGAL FEES IN AN ERISA FIDUCIARY CLAIM A dispute results in a \$100 court award. Plaintiff's legal fees are generally paid as an additional remedy or form of damages. Assuming a 25% rate for legal fees, the settlement value is increased to \$125.⁵

While the relevant statute is written in an unbiased manner, "a court...may allow a reasonable attorney's fee and costs of action to either party," in actuality, it is a very rare instance where defense costs are recovered from the plaintiffs.⁶ So it is gratifying to see courts apply a rigorous examination to the issue of fee awards in an ERISA matter.

In a recent case, a district court agreed that the plan's fiduciaries had breached their fiduciary duties, but went on to dismiss the bulk of the participants' claims. When considering the plaintiffs' request for attorneys' fees, the court significantly downsized this amount because the plaintiffs had succeeded only "minimally" in their action.⁷ The initial request was for \$2.5 million in attorneys' fees and nontaxable costs, this was then later reduced to roughly \$410,000, or less than 20% of the amount initially sought.⁸


PROXY ACCESS: DENIED

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) included a number of important provisions for all U.S. public companies. One of these provisions dealt with proxy access and gave the Securities and Exchange Commission (SEC) explicit authority to write new proxy access rules on just how to implement these changes. (See *ER Alert: "Executive Risks and the Wall Street Reform and Consumer Protection Act"* [Dodd-Frank] Sept. 2010.)

PROXY ACCESS

Directors of public corporations are nominated and elected each year through a process called "proxy voting." Nominations for director are listed on a piece of paper called the "proxy," which is mailed to all shareholders. They usually receive one vote for every share they own. The nominations for directors, however, are not made by the shareholders themselves. Instead, the nominating and governance committee of the board - sometimes in consultation with management - selects the nominees. In theory the board best knows the specific qualifications and expertise that are required to fill a vacancy. Critics of this system advocate that the rules be changed so that major shareholders are given the right to make their own nominations. This is known as "proxy access." Rules for proxy access are currently being considered in many countries. In the U.S. this has been assigned to the Securities and Exchange Commission under the Dodd-Frank Bill of 2010.

*Financial Times Lexicon*⁹



The SEC's proxy access rules would require public companies to include in their annual proxy materials the names of director candidates nominated by shareholders or shareholder group holding (for at least three years) at least 3% of the company's voting power. Shareholders would be able to nominate up to 25% of the board.¹⁰ The rules were scheduled to take effect in November 2010 for most companies and three years later for smaller reporting companies. Within a matter of days after their publication, a petition was filed seeking judicial review.

A federal appeals court panel recently threw out the challenged regulation because the Commission failed to adequately assess its economic effects.¹¹ Currently, outside groups mounting a proxy contest to elect board candidates must pay for the distribution of materials; the SEC's rules would have shifted these costs to the companies themselves. The panel said the Commission had not sufficiently supported its conclusion that increasing the potential for shareholder-nominated directors would improve performance and shareholder value. Rather, the SEC "acted arbitrarily and capriciously" in failing to adequately consider the rule's effect on "efficiency, competition and capital formation."

In response to this defeat, the SEC has announced that it will not appeal this holding. According to the agency's chairwoman:

"I firmly believe that providing a meaningful opportunity for shareholders to exercise their right to nominate directors at their companies is in the best interest of investors and our markets. It is a process that helps make boards more accountable for the risks undertaken by the companies they manage. I remain committed to finding a way to make it easier for shareholders to nominate candidates to corporate boards. At the same time, I want to be sure that we carefully consider and learn from the Court's objections as we determine the best path forward. I have asked the staff to continue reviewing the decision as well as the comments that we previously received from interested parties."¹²

So, the SEC is not ready to scrap the proxy voting rules altogether, and its other modification to proxy voting – amendments to Rule 14a-8, which provides that eligible shareholders are permitted to require companies to include shareholder proposals regarding proxy access procedures in company proxy materials, has been released from its voluntary stay. Under this regulation, shareholders and companies can establish proxy access standards on a *company-by-company* basis rather than per a specific standard for all, such as contained in Rule 14a-11.¹³ This issue is global in scope and something that we will not have heard the last of, so stay tuned for more developments.

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¹ *Caroline DeLia vs. Verizon Communications Inc. et al*, (No. 09-2667, August 24, 2011) from the U.S. Court of Appeals, First Circuit.

² The plaintiff had actually worked for a subsidiary of a subsidiary, leading to multiple subsidiaries being named as defendants in addition to the ultimate parent organization (and potential deep pocket).

³ Additional evidence included the employee's office key card, which displayed the parent company's logo.

⁴ 29 U.S.C. § 1132(g)(1) and 29 U.S.C. § 1132(g)(2).

⁵ Apologies for the simplistic nature of these examples, which were intended to demonstrate the potential inflationary impact of fees in ERISA matters. In fact, courts have generally calculated fees by starting with a "lodestar" calculation, multiplying a reasonable number of hours by a reasonable rate rather than using a flat percentage.

⁶ Also note that one does not have to prevail to receive a reward of fees.

⁷ *Tibble v. Edison International* (CV 07-5359 SVW, July 8, 2010), from the U.S. District Court for the Central District of California.

⁸ "Court Denies Attorneys' Fees in Institutional versus Retail Shares Case," August 29, 2011 (*PLANSPONSOR.com*). The complaint had alleged that a breach of fiduciary duty arose when plan fiduciaries selected retail-class mutual funds for the plan's investment options rather than attempting to secure institutional-class mutual funds.

⁹ <http://lexicon.ft.com/Term?term=proxy-access>.

¹⁰ SEC Rule 14a-11.

¹¹ *Business Roundtable et al v. Securities and Exchange Commission* (No. 10-1305, July 22, 2011) from the U.S. Court of Appeals for the District of Columbia Circuit.

¹² <http://www.sec.gov/news/press/2011/2011-179.htm>.

¹³ Although the amendments to Rule 14a-8 weren't challenged in the litigation, the SEC had voluntarily stayed its effective date at the time it stayed the effective date of Rule 14a-11, the subject of the litigation. Absent further Commission action, Rule 14a-8 went into effect as of September 13 and a notice of the effective date of the amendments will soon be published. Also from <http://www.sec.gov/news/press/2011/2011-179.htm>.