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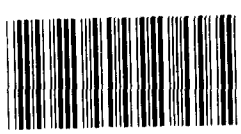
Report to the Chairman, Permanent Subcommittee on Investigations, Committee on Governmental Affairs, U.S. Senate

March 1988

DEPARTMENT OF LABOR

Pension Plans and Corporate Takeovers



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General Accounting Office
Washington, D.C. 20548

Human Resources Division

B-230377

March 31, 1988

The Honorable Sam Nunn
Chairman, Permanent Subcommittee
on Investigations
Committee on Governmental Affairs
United States Senate

Dear Mr. Chairman:

This report is in response to your request for a review of the Department of Labor's enforcement efforts, under the Employee Retirement Income Security Act (ERISA), concerning the potential misuse of pension plans in corporate takeovers. These takeovers generally refer to changes in ownership or control of corporation assets.

ERISA is designed to protect the rights of workers and their beneficiaries under private pension (as well as health and welfare) plans; among other things, the act establishes standards of conduct for plan fiduciaries, that is, those who have discretionary authority or control over the administration and management of plan funds and assets. ERISA requires that fiduciaries, in carrying out their responsibilities, always act prudently and solely in the interest of plan participants and beneficiaries. Labor has primary responsibility for enforcing ERISA's fiduciary standards; this responsibility has been delegated to Labor's Pension and Welfare Benefits Administration (PWBA).

The Employee Benefit Research Institute (EBRI) estimates that as of December 31, 1986, pension plans held approximately 17 percent of all corporate stock and 7.6 percent of taxable bonds traded in the financial markets (see p. 8, fn. 2). Because of the extent of this investment, some plans have become involved in corporate takeovers. Concerns have been raised that (1) pension plan funds have been used to further or thwart takeovers, to the detriment of plans' participants and beneficiaries, and (2) some ERISA fiduciaries' investment and voting decisions in takeover situations reflect conflict of interest (see p. 9, fn. 5).

Because of your request and discussions with your office, we agreed to review Labor's efforts to enforce ERISA in relation to pension plans and corporate takeovers. We identified and summarized (1) how Labor becomes aware of takeovers involving pension plans, (2) Labor's investigations of the potential misuse of pension plan assets in corporate takeovers, and (3) Labor's positions on takeover issues in legal cases as well as advisory opinions and letters to fiduciaries on proposed transactions

(see p. 10, fn. 6). We also agreed to determine Labor's actions in response to recommendations in the April 1986 report of the Subcommittee on Oversight of Government Management, Senate Committee on Governmental Affairs (see p. 9, fn. 5), which deals with pension plans and corporate governance (see p. 10, fn. 8).

We did our review primarily at Labor's Washington headquarters. Here we examined records of ERISA investigations relating to pension plans and corporate takeovers; identified pertinent Labor advisory opinions and letters; examined lawsuits involving pension plans and takeovers; and discussed, with Labor officials, the enforcement of ERISA relative to pension plans and corporate takeovers. Our work was done primarily from May 1987 to January 1988.

Results in Brief

This is a summary of what we found:

- Labor staff have informally learned of takeover transactions involving pension plans from representatives of the plans, other parties involved in takeover transactions, the Securities and Exchange Commission, tips, industry contacts, and newspaper and journal articles (see p. 11).
- Since its establishment in March 1985, the Division of Investigations in PWBA has made 27 investigations of the potential misuse of pension plan assets in corporate takeovers. As of January 1988, 21 of the investigations were closed and 6 were ongoing. Of the 21 closed investigations, 19 resulted in a determination that no further action was necessary by Labor. Of the remaining 2 investigations, the first resulted in Labor's filing a civil lawsuit in which it asserted the need for fiduciary independence to avoid conflict of interest in takeover situations; the second resulted in Labor's sending an advisory letter to the plan's fiduciaries, helping to stop the plan's proposed purchase of its sponsoring corporation's stock for an unfair price. Appendix II includes summaries of the issues and outcomes in the closed and ongoing investigations (see pp. 17-19).
- Labor has, through PWBA and its Solicitor's Office, issued one advisory opinion and three advisory letters to fiduciaries or their legal representatives concerning proposed takeover-related transactions; Labor has also filed four civil lawsuits and two friend-of-the-court briefs in two other civil lawsuits related to corporate takeover issues and pension plans. The four lawsuits were settled wholly or partially in ways that were consistent with positions taken by Labor. The two lawsuits in which Labor filed friend-of-the-court briefs were still pending as of January 7, 1988. Labor's positions on takeover issues have included these:

(1) Plan assets should not be used to either promote takeovers or protect corporations and their management from takeovers. (2) Fiduciaries must be independent, particularly when conflict of interest arises in takeover situations. Labor's positions in the lawsuits and briefs are summarized in appendix III and its positions in the advisory opinion and letters are summarized in appendix IV (see pp. 20 and 23).

- Labor disagrees with and has not acted on the following recommendations of the Senate Subcommittee on Oversight of Government Management: (1) consider requiring public disclosure of fiduciaries' stock voting policies and procedures as well as votes cast (see p. 8, fn. 3); (2) do a review of whether plan sponsors should be required to retain stock voting authority; and (3) issue a policy statement concerning fiduciaries' responsibilities in corporate governance. These recommendations were a result of the Subcommittee's concern over conflict of interest faced by fiduciaries, particularly during corporate takeover situations, in stock voting and responding to purchase offers for corporate stock held in pension plans' portfolios.
- Labor believes it does not have authority under ERISA to require plan sponsors and fiduciaries to disclose stock voting to the public or to require plan sponsors to retain voting authority. Labor also believes that it has expressed its views on fiduciary responsibilities both formally and informally—that is, in legal cases as well as advisory opinions, letters, and speeches. Therefore, it has not issued a policy statement on fiduciaries' responsibilities in corporate governance. In addition, Labor believes that its views may be more properly presented in the context of specific circumstances. Finally, a survey of fiduciaries' corporate governance practices under ERISA, which was recommended by the Subcommittee, was recently conducted by EBRI with assistance from Labor (see pp. 14-16).

As agreed with your office, we did not obtain written comments from Labor on this report. Labor officials were, however, given an opportunity to review a draft of this report and their comments were considered in its preparation. As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from its issue date. At that time, we will send copies

to the Secretary of Labor and other interested parties. We will also make copies available to others on request.

Sincerely yours,

Janet L. Shikles

Janet L. Shikles
Associate Director

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Abbreviations

DI	Division of Investigations, Pension and Welfare Benefits Administration
EBRI	Employee Benefit Research Institute
ERISA	Employee Retirement Income Security Act
ESOP	Employee Stock Ownership Plan
PD&E	Policy Development and Evaluation
PWBA	Pension and Welfare Benefits Administration
SEC	Securities and Exchange Commission

Department of Labor: Pension Plans and Corporate Takeovers

Background

The Pension and Welfare Benefits Administration (PWBA), within the Department of Labor, administers the Employee Retirement Income Security Act of 1974 (ERISA). ERISA's purpose is to make sure that (1) employees covered by private pension plans (as well as health and welfare plans) receive their promised benefits and (2) plans' funds are used solely in the interest of plan participants and their beneficiaries. The act establishes standards of conduct for plan fiduciaries, that is, those who have discretionary authority or control over the administration and management of plan funds and assets. PWBA has the primary responsibility for enforcing ERISA's fiduciary standards.[1]

Under ERISA, plan sponsors may appoint individuals or firms to be fiduciaries, which may include banks, savings and loan associations, insurance companies, corporate officers, and investment management companies. ERISA requires that fiduciaries prudently manage and invest plan assets and carry out their responsibilities solely in the interests of plan participants and beneficiaries. In enforcing ERISA, Labor may sue for restitution of lost plan assets and obtain injunctions to prevent future breaches of fiduciary duties.

In April 1987, Labor estimated that ERISA covered approximately 915,000 private pension plans and 4.5 million health and welfare plans, with an estimated 75 million participants and about $1.6 trillion in assets. The Employee Benefit Research Institute (EBRI) estimated that as of December 31, 1986, private pension plans held approximately 17 percent of all corporate stock and 7.6 percent of taxable bonds traded in the financial markets.[2] Because of the extent of this investment, some pension plans have become involved in corporate takeovers.

Corporate takeovers generally refer to changes in ownership or control of corporation assets. Pension plan fiduciaries become involved in corporate takeovers principally when (1) investing plan funds in stocks and bonds and (2) voting stock,[3] which they hold as plan investments. When purchase offers are made by persons or groups attempting to take over corporations, fiduciaries (when acting as plan investment managers) must decide whether to sell corporate stock held as plan investments.

[1]The Internal Revenue Service, the Department of Justice, and the Pension Benefit Guaranty Corporation enforce other provisions of ERISA.

[2]EBRI is a nonprofit public policy research organization concerned with employee benefit issues.

[3]Stock voting rights differ by class of stock and number of shares owned; voting is usually done by proxy (a proxy is a document authorizing a specified person to vote corporate stock).

They must also decide how to vote on proposals affecting corporate control, such as antitakeover measures. In addition to corporate stock investments, fiduciaries invest plan funds in high risk, high yield bonds (these bonds are sometimes used to finance takeovers), make commitments to loan money to investors who buy corporations, and invest in pooled funds used for corporate takeovers and leveraged buyouts.[4]

There has been some concern that pension plan funds have been used to further or thwart corporate takeovers, to the detriment of plan participants and beneficiaries; another concern has been that some ERISA fiduciaries' investment and voting decisions in takeover situations show conflict of interest.[5] In takeover situations, fiduciaries may face conflict between the interests of plan sponsors and those of plan participants and beneficiaries. For example, when a corporation is threatened with a takeover, a pension plan fiduciary, who is also an officer or employee of the corporation sponsoring the plan, may make decisions on voting or selling corporate stock out of concern for his or her continued employment, rather than solely in the interest of the plan participants and beneficiaries.

Similarly, fiduciaries who manage investments for several pension plans may face conflict of interest in some takeover situations; for example, when a corporation attempting a takeover or a corporation threatened with a takeover is a client of the fiduciary and has entrusted the fiduciary with significant amounts of plan funds for investing. Out of concern for keeping either party in the takeover struggle as an investment client, the fiduciary may make decisions—buying, selling, and voting stock or investing in corporate bonds—that are not solely in the interest of the pension plans' participants and beneficiaries.

[4]In a leveraged buyout, a group of investors purchases and "takes private" a publicly owned corporation, often in partnership with members of the corporation's management. Most of the purchase price is borrowed, using the assets of the acquired corporation as collateral.

[5]See U.S. Congress, Senate Subcommittee on Oversight of Government Management, Committee on Governmental Affairs, "The Department of Labor's Enforcement of the Employee Retirement Income Security Act," Committee Print (April 1986, Senate Print 99-144), pp. iii, 2, and 43; and U.S. Congress, House Subcommittee on Telecommunications, Consumer Protection, and Finance, Committee on Energy and Commerce, "Pension Funds in the Capital Markets," Hearing (Washington, D.C., March 19, 1986), Serial Number 99-92, p. 3; and U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, "Employee Ownership [and] Hostile Takeovers," Hearing (Washington, D.C., June 26, 1987), Senate Hearing No. 100-157, pp. 1 and 4.

Objectives, Scope, and Methodology

As agreed with the Office of the Chairman, Permanent Subcommittee on Investigations, Senate Committee on Governmental Affairs, we concentrated our review on Labor's efforts to enforce ERISA in relation to pension plans and corporate takeovers, in particular,

- how Labor becomes aware of takeovers involving pension plans,
- Labor's investigations of the potential misuse of pension plan assets in corporate takeovers, and
- Labor's positions on takeover issues in legal cases and in advisory opinions and letters.[6]

We also agreed to determine Labor's actions in response to a congressional subcommittee's April 1986 recommendations,[7] dealing with pension plans and corporate governance issues.[8]

We did our work primarily at Labor's Washington, D.C., headquarters, where we obtained data on 71 ongoing and closed investigations; these were conducted by the Division of Investigations (DI), within PWBA's Office of Enforcement, from March 1985 to January 1988. We discussed these investigations with DI's chief. We also examined pertinent documents identified by PWBA and Labor's Office of the Solicitor as involving pension plans and corporate takeovers. The documents included lawsuits, friend-of-the-court briefs that were part of two lawsuits, one advisory opinion, and two advisory letters.

We discussed our work with Labor officials, including PWBA's director of Policy Development and Evaluation (PD&E); associate directors of the Office of Regulations and Interpretations and the Office of Enforcement; the deputy associate director of the Office of Research and Economic Analysis; the chief of DI; and Labor's associate solicitor, Division of Plan Benefits Security, Office of the Solicitor. Our work was essentially done from May 1987 to January 1988 and followed generally accepted government auditing standards.

[6]Advisory opinions and letters are issued by PWBA and represent Labor's opinions as to the application of ERISA to specific situations in prospective transactions.

[7]See U.S. Congress, Senate Subcommittee on Oversight of Government Management, "Labor's Enforcement of the Employee Retirement Income Security Act."

[8]In this report, corporate governance refers to stock voting on issues of corporate control.

Mechanisms for Identifying Takeovers Involving Pension Plans

Labor's enforcement activities concerning pension plans and corporate takeovers are handled by DI staff. DI was created in March 1985 to do special investigations, including those relating to takeovers.[9] As of January 1988, DI had a professional staff of six—two accountants, three lawyers, and a chief.

DI staff informally learn of takeover transactions involving pension plans from representatives of plans or other parties involved, the Securities and Exchange Commission (SEC), tips, contacts in the industry, and newspaper articles and trade publications. According to the DI chief, the staff often become aware of potential transactions, from one or the other of the involved parties, before they are publicly announced. Financiers and law firms representing parties involved in contemplated transactions, for example, request Labor's review of potential takeover deals, provide draft documents to review, and often meet with DI staff. These requests are made to avoid potential ERISA problems, which may trigger a Labor investigation or lawsuit and the attendant negative publicity.

In addition, DI's chief told us that at SEC's request, his staff review potential takeover transactions involving pension plans. The staff identifies these transactions from proposed filings with the SEC (made by parties to takeover transactions) that indicate some involvement of a pension plan's assets.[10] The staff then review the filings to determine whether there are potential violations of ERISA. If so, the SEC requires that these potential violations be adequately disclosed.

Investigations of Takeovers Involving Pension Plans

Since its inception, DI has carried out 71 investigations; 27 have involved takeovers. As shown in table I.1, as of January 1988, 21 takeover investigations were closed and 6 were ongoing. Of the closed investigations, 19 resulted in a determination that no further action was necessary by Labor; 1 resulted in a civil lawsuit; and 1 in an advisory letter, which Labor sent to the pension plan fiduciaries, helping to stop a plan's proposed purchase of its sponsoring corporation's stock for an unfair price.

[9]The DI chief informed us that before March 1985, staff of the Office of Enforcement conducted special investigations, including those related to takeovers. Labor did not maintain records accounting for these investigations.

[10]Takeover-related filings submitted to SEC generally include purchase offers and financial disclosure statements.

Table I.1: Status of Takeover Investigations by DI, January 1988

Closed investigations	
No action necessary	19
Letter issued	1
Civil lawsuit	1
Subtotal	**21**
Ongoing investigations	
In process	6
Total	**27**

The following are examples of the issues in DI's takeover investigations: formation of Employee Stock Ownership Plans (ESOPs),[11] purchases through a form of leveraged buyout of a majority of companies' stock by ESOPs and management,[12] profit- sharing between an investment management company and pension plans in partnerships that invest in takeovers, the suspected misuse of pension plan assets in takeovers, and fiduciaries' voting in a takeover struggle.[13] Summaries of DI's 27 takeover investigations are presented in appendix II.

Positions on Takeovers in Civil Lawsuits, Advisory Opinions, and Letters

According to officials in Labor's Solicitor's Office and PWBA, since the early 1980's, Labor has filed four civil lawsuits against plan administrators or fiduciaries concerning alleged misuse of pension plan assets in corporate takeovers. Labor also intervened in a fifth lawsuit, brought by plan participants, by filing a friend-of-the-court brief; Labor suggested that fiduciaries who are employees of a plan's sponsoring corporation resign when the corporation is involved in a takeover struggle. In a sixth lawsuit, Labor filed a brief concerning plan provisions covering the plan's acquisition and sale of stock in the sponsoring corporation. The

[11]ESOPs are employee benefit plans designed to give employees the opportunity to acquire stock in their corporation, while affording employers an innovative method of corporate capital financing. Some ESOPs have been used to defend against takeovers. The ESOPs, sometimes along with other investors (such as existing management), buy and keep a majority of the sponsoring corporation's stock, thereby making the stock unavailable for purchase by others wanting to take over the corporation.

[12]In a leveraged buyout by an ESOP, the ESOP borrows to purchase stock of the corporation that established the ESOP, and the corporation obligates itself to contribute amounts to the ESOP sufficient to enable the ESOP to service the debt.

[13]In a report concerning leveraged buyouts, the Congressional Research Service suggests that the Congress may wish to consider the need for additional oversight, by Labor and other federal agencies, of ESOPs in takeovers and leveraged buyouts (Congressional Research Service, "Leveraged Buyouts and the Pot of Gold; Trends, Public Policy, and Case Studies" [prepared for the Subcommittee on Oversight and Investigations of the House Committee on Energy and Commerce, Dec. 1987], Committee Print 100-R., pp. xvii and 62).

four civil lawsuits filed by Labor were settled wholly or partially in ways that were consistent with positions taken by Labor. The two lawsuits in which Labor filed friend-of-the-court briefs were still pending as of January 7, 1988.

In addition, PWBA has issued one advisory opinion and three advisory letters to fiduciaries or their legal representatives about pension plans, corporate governance, and takeover issues arising in proposed transactions. Advisory opinions and letters represent Labor's opinions as to the application of ERISA to specific situations in prospective transactions.

Overall, in the legal cases, advisory opinion, and letters, Labor has taken the following positions concerning takeover issues:

- Plan assets should not be used to either promote takeovers or protect corporations and their management from takeovers.
- Fiduciaries must be independent, particularly when conflict of interest arises in takeover situations.
- Plans cannot pay more than fair market value for stock of the corporations that established them.
- Plan investments in the sponsoring corporations' securities (for example, stocks and bonds) must be prudent under ERISA, even if plan provisions mandate the acquisition and holding of such securities.
- Agreements to indemnify fiduciaries for breaches of their ERISA fiduciary duties are not legally binding.
- Fiduciaries are responsible for assuring that accurate information is distributed to help plan participants make their voting decisions.
- If fiduciaries have delegated voting authority to investment managers on plan-owned stock, the fiduciaries do not have authority to direct investment managers' voting.

Summaries of the six lawsuits are in appendix III; summaries of the advisory opinion and letters are in appendix IV.

Actions on Recommendations by the Subcommittee on Oversight of Government Management

In addition to discussing Labor's overall enforcement of ERISA, the April 1986 report of the Senate Subcommittee on Oversight of Government Management made several recommendations to Labor about the responsibilities of pension plan fiduciaries in corporate governance issues. The Subcommittee was concerned about conflict of interest faced by fiduciaries, particularly, during corporate takeover situations, in voting and responding to purchase offers for corporate stock in pension plans' portfolios. The Subcommittee's recommendations and Labor's responses are summarized below:

Recommendation 1: Labor should issue a policy statement specifying the responsibilities of fiduciaries in the corporate governance area.

According to the Subcommittee, Labor's efforts to clarify fiduciary obligations in the corporate governance area would heighten fiduciaries' awareness and understanding of their obligation to act solely in the interest of plan participants and beneficiaries. The Subcommittee stated that (1) in preparing a policy statement, Labor should include a discussion of fiduciaries' duties in voting on antitakeover charter amendments and (2) there was considerable confusion about fiduciaries' obligations in responding to purchase offers for stock.

According to PWBA's director of PD&E, Labor has expressed its views on issues in this area both formally and informally—that is, in legal cases, advisory opinions, and speeches by Labor officials. He said that Labor has taken the position that fiduciaries have an obligation under ERISA to (1) carefully evaluate corporate governance issues that can affect the value of plan investments and (2) take only those actions that are consistent with the interest of plan participants and beneficiaries.

For example, although ERISA is silent on the subject of voting, the Secretary of Labor in a 1986 speech stated, as quoted below, that voting is subject to the act's fiduciary standards:

"It is the fiduciary's duty to make investment decisions solely in the interest of participants and beneficiaries and exclusively for the purpose of paying benefits. With regard to corporate governance, plan fiduciaries cannot be passive shareholders. Specifically, proxy votes that affect the economic value of plan investments unquestionably involve the exercise of fiduciary responsibility. Those votes must be cast in a way that the fiduciary believes will maximize the economic value of plan holdings."

PWBA believes (1) it would not be appropriate for Labor to issue a policy statement on voting, telling fiduciaries how to vote or whether to sell stock and (2) Labor will, as in the past, issue opinions or take legal actions based on evaluation of the specific facts and circumstances of cases presented.

Recommendation 2: Labor should consider requiring public disclosure of voting policies and procedures, as well as actual votes cast by fiduciaries.

The Subcommittee stated that conflict of interest results in some fiduciaries' using voting to pursue their own economic interests; disclosure would go a long way toward eliminating abuses. Knowing that voting can be subject to outside scrutiny, fiduciaries would be encouraged to engage in a more careful evaluation of corporate governance issues.

According to PD&E's director, Labor does not believe that it has authority under ERISA to require plan sponsors and fiduciaries to publicly disclose voting policies, procedures, and actual votes cast. He also indicated that Labor has not considered requesting such authority.

Recommendation 3: Labor should review the potential requirement that pension plan sponsors retain voting responsibility for stock held in their plans' portfolios.

The Subcommittee stated that further study is required in order to determine whether plan sponsors may be in a better position than outside investment managers to vote stock owned by their plans. The Subcommittee questioned the common practice of delegating voting to outside investment managers who may not act in the best interest of plan participants.

PD&E's director indicated that Labor (1) does not have the authority to require plan sponsors to retain voting responsibility, (2) has not considered requesting such authority, and (3) has not studied whether plan sponsors should be required to retain this responsibility.

Recommendation 4: Labor should conduct a survey of the corporate governance practices of ERISA fiduciaries.

The Subcommittee noted that there is very little information available on corporations' policies and practices concerning pension funds and corporate governance. The PD&E director said that more candid

responses could be obtained from a survey done by an outside organization (which was not a regulatory and enforcement agency) than from a survey done by Labor. Accordingly, Labor worked with EBRI in planning a survey on voting practices and policies of private pension plans' sponsors, master trustees (a type of fiduciary), and investment managers.[14] The survey was done in February-March 1987 by EBRI in conjunction with the Committee on Investment of Employee Benefit Assets (of the Financial Executives Institute) and the Association of Private Pension and Welfare Plans.

In its September 1987 report, EBRI stated that the survey information was gathered from 334 corporate plan sponsors, 134 investment managers, and 25 trustees. The private pension plan sponsors and others who responded account for about 42 percent of stock held by private pension funds and about 25 percent of total private pension assets.

EBRI's survey found that

"Most plan sponsors have their funds managed externally [and] are unlikely to communicate with . . . managers on voting issues, but instead . . . give . . . external managers a large amount of discretion on voting matters . . . . Most external [outside] investment managers vote their proxies and have internal written guidelines for voting. Many have guidelines for voting on particular takeover issues. But, some also report having experienced direct or indirect pressure to influence their proxy votes and have established written policies to deal with such pressure."

According to PWBA's deputy associate director of the Office of Research and Economic Analysis, Labor officials believe that the EBRI survey did not provide any conclusive or clear indication that conflict of interest is a serious problem in proxy voting; the survey, on the contrary, provided some reassurance that it is not. This official told us that Labor is not currently planning any further research on corporate governance practices.

[14]Employee Benefit Research Institute, Voting Private Pension Proxies: Some New Evidence and Some Old Questions (Sept. 1987).

PWBA's Division of Investigations' 27 Takeover Investigations,[a] March 1985-January 1988 (Summaries)

Investigation	Issues and outcomes in closed investigations
1	To avoid a takeover, a corporation created an ESOP to buy a majority of the corporation's stock. Labor determined that the investment advisor to the ESOP proposed fees that would have been illegal if paid. The takeover deal fell through, and the investment advisor informed Labor that he would not propose such fees again.
2	In this leveraged buyout by an ESOP, Labor reviewed whether a fair price was paid by the ESOP for the corporation's stock. After an investigation, Labor determined that (1) the price was within a reasonable range and (2) Labor had no basis to contest the independent valuation of the price paid.
3	Labor reviewed whether (1) an ESOP formed as a takeover defense was established solely in the interest of the participants and (2) the ESOP paid a fair price for its sponsoring corporation's stock. Labor determined that the rights of the participants were protected and no further action was necessary.
4	In this leveraged buyout by an ESOP and a management group, Labor reviewed whether a fair price was paid by the ESOP for the corporation's stock. After significant changes were made to the original proposal, Labor determined that the transaction appeared to be fair and that no further action was necessary.
5	Labor reviewed two ESOPs' attempted takeover of a corporation (other than their sponsor), determined that (1) the transaction was profitable to the plans and (2) no further action was necessary.
6	Labor reviewed whether (1) an ESOP formed to defend against a takeover was in the best interest of the plan's participants and (2) the price paid by the ESOP for its sponsoring corporation's stock was fair. Labor determined that (1) the ESOP's formation was in the best interest of the participants and (2) the price paid for the stock was fair.
7	Labor issued a letter that stopped an ESOP's proposed leveraged buyout for more than a fair price. A new price was then negotiated, but the corporation's board of directors declined to consummate the transaction.
8	Labor was requested by SEC to review a proposed leveraged buyout by an ESOP. The case was closed when the ESOP buyout became moot because an outside purchase offer at a higher price was accepted.
9	In this leveraged buyout, an ESOP paid in excess of a fair price for a corporation; but the ESOP's fiduciaries sued, and a settlement was reached that corrected the inequity. Labor monitored the lawsuit and closed its file when appropriate relief was obtained.
10	Participants in an ESOP complained to Labor that the owner of the corporation was attempting to sell stock to the ESOP at an inflated price. The stock purchase was not completed, and Labor determined that no further action was necessary.

(continued)

Investigation	Issues and outcomes in closed investigations
11	Labor reviewed this leveraged buyout by an ESOP and management, determining that the transaction appeared to be fair to the ESOP.
12	Labor's investigation resulted in a successful lawsuit, highlighting the need for fiduciaries' independence in takeover struggles to avoid conflict of interest.
13	Labor officials monitored this takeover to make sure that the ESOP's assets were not inappropriately used by the acquiring corporation. Labor determined that they were not and closed the investigation.
14	Labor reviewed the fairness of the price to be paid by an ESOP for its purchase of corporation securities to defend against a takeover. No action was necessary because the securities were not purchased.
15	Labor reviewed documents in a takeover attempt, looking for potential involvement of the corporation's two benefit plans, one an ESOP, in defending against the takeover. Labor found little likelihood of involvement because the plans owned less than 3 percent of the corporation's outstanding stock.
16	A corporation attempted to have its ESOP file a lawsuit to help fight a takeover attempt; the corporation proposed to indemnify the ESOP for any ERISA violations (this agreement would have been void under ERISA). The corporations involved in the takeover struggle reached agreement and the proposed lawsuit was dropped, with the ESOP suffering no losses. Labor closed the case.
17	In order to negate a takeover threat, a corporation purchased its own stock at a premium price from the party attempting the takeover. Labor suspected that plan assets were used, but found that they were not.
18	Labor determined that (1) a pension plan's investment of a small portion of its assets in high risk, high yield bonds—used to finance takeovers—was not imprudent under the circumstances and (2) fees for investment commitments by plans were properly distributed to the plans, even in instances when the investments did not occur.
19	Labor reviewed the appropriateness and profitability of pension plans' stock and bond investments in limited partnerships or pooled funds whose purpose was to take over corporations and resell them. Labor did not find any ERISA violations and determined that the plans had earned significant returns on their investments.
20	Labor reviewed this leveraged buyout by two ESOPs and another purchaser to determine the fairness of the distribution of stock ownership among the ESOPs and the other purchaser. After an investigation, Labor determined that no further action was necessary because revisions to the transaction brought the sharing of stock ownership closer to Labor's standards than was originally proposed.
21	Labor began to review the filed purchase offer, but the proposed transaction was dropped. Labor determined that no further action was necessary.

Investigation	Issues in ongoing investigations
1	Labor is investigating allegations that investors were pressured to vote in favor of corporate antitakeover amendments proposed by management.
2	To determine if plan assets were improperly used, Labor is reviewing information it subpoenaed on the financing of a takeover.
3	Labor is reviewing issues concerning a plan sponsor's retention of voting rights for stock held by the plan's investment manager.
4	The management of a corporation formed an ESOP to purchase the corporation from the widow of its former owner. Labor is reviewing the appropriateness of the purchase price.
5	Labor's investigation indicates that the ESOP was formed as an antitakeover device, and it paid less for the purchase of a minority interest in its corporation's stock than third parties—who were seeking a controlling interest—were willing to pay. Labor is concerned that in the future, ESOP stock may not be voted solely in the interest of plan participants and beneficiaries.
6	Labor is reviewing the fairness of the price paid by an ESOP for stock. The purchase was part of a leveraged buyout of segments of a corporation by the ESOP, management, and private investors.

[a]These brief summaries of investigations are provided to indicate the types of takeover issues Labor has investigated.

Labor's Positions on Takeover Issues in Civil Lawsuits, May 1982-January 1988 (Summaries)

Lawsuit 1

Labor filed a lawsuit contending that the president of a corporation had violated his fiduciary duties. As fiduciary of the corporation's ESOP, he had caused it to purchase shares of the corporation's stock while the corporation was defending an ultimately unsuccessful takeover attempt. Labor asserted that the plan's fiduciary needed to be independent in a takeover battle; this was because of the inherent conflict of interest in his dual role as an ESOP fiduciary and corporation president. Labor requested that the plan fiduciary be replaced by the appointment of a receiver. The court did not agree that a violation of fiduciary duties had occurred because evidence showed that the ESOP's stock purchase had been planned before the takeover. The court did agree, however, that an inherent conflict of interest existed in the president's dual role. He voluntarily resigned and was replaced; other fiduciaries were appointed. Two were eventually approved by the court. After the takeover attempt expired, the court considered the controversy moot and the need for a receiver unnecessary. The lawsuit was decided on May 13, 1986.

Lawsuit 2

The court agreed with Labor that pension plan assets may not be used to protect a corporation and its management from a change in control. The court found that the fiduciaries purchased company stock to defeat a takeover attempt; this violated ERISA's rule that fiduciaries' actions be prudent and solely in the interest of plan participants. The court issued an order barring plan fiduciaries from buying or selling company stock for the plan. The court did not agree with Labor's argument that it is per se unlawful for a plan's fiduciary to act on the plan's behalf in every situation where the (1) fiduciary is an officer or employee of the plan's sponsoring corporation and (2) corporation is threatened with a takeover. Labor contended that in all such situations, the fiduciary's dual loyalties (to the corporation and the plan) would prevent him or her from acting exclusively in the plan's interest. The court did say, however, that fiduciaries have a duty to avoid placing themselves in positions where they cannot function with complete loyalty to plan participants. The lawsuit was decided May 10, 1982.

Lawsuit 3

In this case, Labor filed a lawsuit charging that plan assets had been used by fiduciaries to advance their personal and corporate interests in several takeover transactions; this was at the expense of the pension plans and their participants. Labor and the fiduciaries reached an agreement, approved by the court on January 18, 1984, that, among other things, appointed an independent fiduciary to manage and sell stock

acquired during one of the attempted takeovers and enjoined the fiduciaries from further violation of ERISA's fiduciary standards.

Lawsuit 4

In this instance, Labor established the principle that pension plan assets cannot be used to promote takeover attempts by the plan's sponsoring corporation. Plan administrators had invested the plan's assets in stock of corporations they were attempting to take over; both the plan and its administrators profited from the investments. Labor filed a friend-of-the-court brief suggesting that when a takeover struggle is in motion, a fiduciary should resign and a neutral trustee be appointed to manage a plan's assets. In its January 27, 1984, decision, the court agreed that Labor's suggested action was advisable to avoid conflict of interest in the actions of fiduciaries, but did not state that such action was legally required. Instead, the court examined the actions of the plan administrators and determined that they had not acted in the sole interest of plan beneficiaries. The court concluded that the plan administrators had violated fiduciary standards by risking plan assets to further their own interests. Despite the fact that plan beneficiaries earned a substantial return on the investments, the court said that they could sue to recover profits made by fiduciaries through misuse of plan assets.

Lawsuit 5

In this instance, four plans continued to own preferred stock in their sponsoring corporation after a takeover. This preferred stock was issued to the plans as part of a collective-bargaining agreement with the sponsoring corporation. Later, the sponsoring corporation was taken over by a second corporation and that second corporation proposed to cancel the preferred stock in exchange for cash or a new series of its stock. After stockholders defeated the proposal, an affiliate of the second corporation made an offer to purchase the preferred stock still owned by the plans. Unions representing the employees covered by the plans have filed suit to obtain a determination from the court as to fiduciaries' duties under ERISA in responding to the purchase offer. For two of the pension plans, provisions restrict fiduciaries' authority to sell the preferred stock; for two other plans, provisions allow employees to decide whether to sell the preferred stock. On November 5, 1987, Labor filed a friend-of-the-court brief concerning these provisions. Labor stated that ERISA explicitly requires plan fiduciaries to discharge their duties in accordance with plan provisions, if these provisions are consistent with ERISA's prudence requirement. Labor also noted that investments in sponsoring corporations' securities must meet the test of prudence even if plan provisions mandate the acquisition and holding of

such securities. When employees' control over plan investments is merely a one-time decision on whether to sell stock in response to a purchase price, ERISA still does not relieve fiduciaries of responsibility for employees' decisions. Fiduciaries must assure that employees are provided necessary and not misleading information for their decisionmaking. This lawsuit was pending as of January 7, 1988.

Lawsuit 6

Labor filed this lawsuit on April 14, 1986, alleging that there were breaches in fiduciary duties when ESOP fiduciaries failed to enforce an irrevocable contractual commitment that the corporation had made to the ESOP—to transfer surplus assets from two previously terminated pension plans to the ESOP. According to Labor, in the hope of discouraging a takeover, the corporation made the plans' surplus assets unavailable by (1) terminating its two pension plans, (2) establishing an ESOP, and (3) committing the terminated plans' surplus assets to the ESOP. Labor sought enforcement of the contractual commitment to the ESOP. This lawsuit was pending as of January 7, 1988.

Labor's Advisory Opinion and Letters on Takeover Issues, September 1983-February 1988 (Summaries)

Advisory Opinion 1

On April 30, 1984, Labor issued an advisory opinion to the legal representative of a pension plan fiduciary on fiduciary responsibilities in attempted corporate takeovers. At that time, the plan's sponsoring corporation was defending against a takeover attempt. There was potential for conflict of interest because the fiduciary also had a commercial banking relationship with the corporation.

Labor warned the fiduciary: If plan participants are subjected to pressure from the sponsoring corporation to vote in a particular manner, it would be the fiduciary's duty to ignore participants' directions since it could not be considered proper. According to Labor, as mentioned earlier, fiduciaries are responsible for assuring that necessary and not misleading information is provided for decisionmaking.

Advisory Letter 1

To determine if the participation of a corporation's two ESOPs and a thrift-savings plan in a proposed leveraged buyout of the corporation was adequately disclosed, SEC staff requested that Labor view relevant material. Labor issued an advisory letter on September 12, 1983, expressing concern over conflict of interest in fiduciary decisions relative to the buyout. This was because members of the committee of fiduciaries responsible for the plans were also to be directors of the new corporation to be formed after the buyout. According to Labor, the plans' fiduciaries (1) must reach careful and considered decisions in full awareness of their fiduciary responsibilities and the accompanying liabilities and (2) in reaching those decisions, should consider only the interest of the plans' participants and their beneficiaries. Labor also warned that any agreement proposed by the corporation to indemnify plan fiduciaries for breaches of ERISA's fiduciary duties would be invalid.

Advisory Letter 2

In this instance, a leveraged buyout of a corporation was proposed by a group of investors, including the corporation's management, an affiliate of an investment banking company, and an ESOP to be established by the corporation. The terms of the buyout provided that public shareholders' stock be purchased. The ESOP was to borrow from the corporation to purchase stock.

Labor expressed concern that if the proposed buyout was completed (1) the ESOP would pay more than a fair market value for stock; (2) the ESOP's purchase of the stock would amount to a prohibited transaction; and (3) there would be a breach of fiduciary duty by the ESOP trustee if he or she caused the ESOP to proceed with the transaction. The proposed

buyout was never completed and, according to a Labor official, Labor's July 30, 1985, letter to the fiduciaries helped stop the proposed buyout.

Advisory Letter 3

On February 23, 1988, Labor issued an advisory letter to a plan's fiduciary concerning general ERISA obligations of fiduciaries and investment managers in voting proxies on stock owned by plans. The letter is based on Labor's investigation of a plan sponsor's alleged attempt to direct investment managers' voting of stock held for the plan. Labor stated that although the investigation was inconclusive, it was providing the letter because of the recurring nature of the issues and the possibility that ERISA violations had occurred.

According to Labor, when an investment manager is appointed and given investment authority for a plan, including voting authority, it would be an ERISA violation if any person other than the investment manager was to make proxy voting decisions, unless, in the delegation of authority to the investment manager, such a right was specifically reserved. If a fiduciary has delegated the responsibility for proxy voting to an investment manager, the fiduciary no longer has the authority to decide how the investment manager votes. Furthermore, Labor pointed out, without such specific reservation of rights, an investment manager responsible for voting would not be relieved of any potential fiduciary liability if he (1) was directed by another how to vote or (2) delegated to another voting proxies. Labor also stated that ERISA requires that fiduciaries monitor and document activities of investment managers, including voting.

Labor's investigation involved investment managers' voting on issues that Labor believes could affect the value of the plan's stock investments, specifically, proposals to change the state of incorporation and rescind antitakeover measures of corporations in which the plan holds stock. Labor noted in its letter that it has construed ERISA's requirements (as mentioned earlier, that a fiduciary act solely in the interest of, and for the exclusive purpose of, providing benefits to plan participants and beneficiaries), as prohibiting a fiduciary from subordinating the participants' and beneficiaries' interest in their pension plans to unrelated objectives.

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