

MEMORANDUM

February 22, 2008

TO: Council of Institutional Investors

FROM: Ian D. Lanoff

RE: DOL Advisory Opinion 2007-07A

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On December 21, 2007, DOL issued Advisory Opinion 2007-07A in response to a letter from the U.S. Chamber of Commerce. You have asked whether the new advisory opinion reflects a change in DOL guidance on the voting of proxies owned by employee benefit plans subject to the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). As discussed below, we do not believe that that the new opinion reflects a change in DOL's views regarding proxy voting as expressed in DOL Interpretive Bulletin 94-2 (July 29, 1994). 29 C.F.R. § 2509.94-2.

A "fiduciary" of an ERISA-covered plan is any person who, in part, "exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets." ERISA § 3(21)(i). This definition would include the trustees of a multiemployer pension or benefit plan. ERISA provides that a fiduciary of an ERISA-covered employee benefit plan "shall discharge his [or her] duties with respect to a plan solely in the interest of the participants and beneficiaries and (A) for the exclusive purpose of (i) providing benefits to participants and their beneficiaries; and (ii) defraying reasonable expenses of administering the plan." ERISA § 404(a)(1)(A). This is generally referred to as the "duty of loyalty" or the "exclusive purpose" rule. Under this rule, fiduciaries must act solely in the interest of plan participants and beneficiaries in making decisions concerning the management or disposition of plan assets. *See* DOL Adv. Op. 85-36A (Oct. 23, 1985) (construing "the requirement that a fiduciary act solely in the interest of, and for the exclusive purpose of providing benefits to, participants and beneficiaries"). ERISA also requires fiduciaries to act "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims." ERISA § 404(a)(1)(B). This is generally referred to as the "duty of prudence."<sup>1</sup>

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<sup>1</sup> ERISA also imposes other duties on fiduciaries, including the duty to diversify the investments of the plan, ERISA § 404(a)(1)(C), and the duty to comply with the documents governing the plan insofar as such documents do not violate the provisions of ERISA. ERISA § 404(a)(1)(D).

In Interpretive Bulletin 94-2, DOL specifically addressed the application of ERISA's fiduciary duties to the exercise of proxy voting and other rights appurtenant to securities owned by the plan. First, "the fiduciary act of managing plan assets that are shares of corporate stock includes the voting of proxies appurtenant to those shares of stock." DOL I.B. 94-2. Second, it concluded that "the fiduciary duties [of loyalty and prudence] require that, in voting proxies, the responsible fiduciary consider those factors that may affect the value of the plan's investment and not subordinate the interests of the participants and beneficiaries in their retirement income to unrelated objectives." *Id.* And, third, "a fiduciary should expend plan assets in voting (or to exercise other shareholder rights) only if it is determined that "the plan's vote, either by itself or together with the votes of other shareholders, is expected to have an effect on the value of the plan's investment that will outweigh the cost of voting." *Id.* This third principle is essentially requires a "cost-benefit analysis."

In the new advisory opinion, DOL stated that "...the use of pension plan assets by plan fiduciaries to further policy or political issues through proxy resolutions that have no connection to enhancing the value of the plan's investment in a corporation would, in the view of the Department, violate the prudence and exclusive purpose requirements of [ERISA]." This statement reflects the same cost-benefit analysis articulated by DOL in IB 94-1. Where a proxy resolution has *no* connection to enhancing the value of a plan's investment, any cost associated with casting a vote would necessarily outweigh the potential benefit (which would be zero). Where the plan fiduciary can reasonably conclude that a proxy vote *does* have a connection to enhancing the value of the plan's investment, all that is required is that the expected enhancement outweigh the cost of casting that vote. Presumably, if the cost of voting a proxy is low, it may be outweighed by a relatively small potential "benefit" or enhancement to the value of the plan's investment.

DOL's statement in Advisory Opinion 2007-07A that "plan fiduciaries risk violating the exclusive purpose rule when they exercise their fiduciary authority in an attempt to further legislative, regulatory or public policy issues through the proxy process when there is no clear economic benefit to the plan" is also consistent with the 1994 Interpretive Bulletin. If the exercise of the plan's proxy involves some cost to the plan, a fiduciary who casts a vote for a plan without being able to identify the expected benefit to the plan (e.g., an enhancement to the value of the plan's investment) would clearly risk violating his or her duties of loyalty and prudence, because the fiduciary could not have satisfied the cost-benefit test.

The DOL concluded the new advisory opinion by applying the cost-benefit analysis to a specific example identified by the Chamber of Commerce. It stated that "...the likelihood that the adoption of a proxy resolution or proposal requiring corporate directors and officers to disclose their personal political contributions would enhance the value of a plan's investment in the corporation appears sufficiently remote that the

expenditure of plan assets to further such a resolution or proposal clearly raises compliance issues under [ERISA]." In other words, if the potential "benefit" to the plan (an increase in the value of the plan's investment) of pursuing the proxy is, in fact, nil ("sufficiently remote" in DOL's terms), the plan fiduciary will not be able to justify incurring any costs to pursue that proposal. Again, this appears to us to be an application of the cost-benefit analysis articulated in Interpretive Bulletin 94-2 and does not, in our view, reflect a change in that analysis.

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This analysis in this memorandum is based on existing authorities under ERISA. If there are changes to the applicable law, we are under no obligation to update or modify this memorandum. It is possible that a court or DOL could disagree with our conclusions.