H.R. Employee Benefits & Internal Controls E-Update

Executives, Other Business Partners Face ERISA Liability Risks If Bankrupt or Distressed Company Mismanages Employee Benefit Plan Responsibilities

June 11 Supreme Court Decision On ERISA Fiduciary Responsibility In Bankruptcy Released

June 13, 2007

Executives, board members, and other business leaders of companies providing health, 401(k) or other employee benefits under plans regulated by the Employee Retirement Income Security Act of 1974, as amended (ERISA) should heed the United States Supreme Court's June 11, 2007 decision in *Beck v. Pace International, Inc.*[i] and a mounting series of recent fiduciary liability settlement orders, judgments and prosecutions announced by the U.S. Department of Labor (Labor Department) as important reminders of the potential personal liability exposures executives can may face if their company's benefit programs are not appropriately maintained and administered. Banks, lenders and other parties conducting business transactions with companies also should exercise caution to avoid taking on fiduciary liability exposures or getting drawn unintentionally into plan related disputes through their dealings with such companies during times of distress or bankruptcy.

On Monday, the U.S. Supreme Court ruled in *Beck* that a bankrupt employer did not breach its fiduciary duties under the Employee Retirement Income Security Act of 1974, as amended ("ERISA") by refusing to consider a union offer to merge the employer's plans into a union sponsored multi-employer plan. While the decision upheld the actions of Pace International, Inc. and its executives in deciding not to accept the union's offer to take over the company's pension plan when the company failed, it highlights the risks that companies and their leaders can face when deciding how to handle employee benefit concerns during times of financial distress.

The *Beck* decision comes at a time when an increasing number of business leaders are facing challenges of meeting their employee benefit plan responsibilities while struggling to keep their businesses viable. The decision coincides with an increase in business and personal bankruptcy filings that analysts predicting will continue throughout 2007.[ii] The rise in financially distressed companies also is reflected in an upturn of Department of Labor enforcement actions against distressed or bankrupt companies and their officers or directors for alleged breaches of fiduciary duties or other mishandling of medical, 401(k) or other pension, and other employee benefit programs sponsored by their financially distressed companies over the past year. Since January 1, the U.S. Department of Labor has filed more than 35 lawsuitsiii seeking to compel distressed companies and/or members of their management to pay restitution or other damages for alleged breaches of ERISA fiduciary duties, the appointment of independent fiduciaries, or both for plans sponsored by bankrupt or financially distressed companies. During that same period, the Labor Department also as announced a host of judgments and/or settlements compelling a wide range of distressed or bankrupt companies and members of their management to pay restitution or other damages for mishandling health, 401(k) or other pension and profit-sharing, or other employee benefit plans sponsored when their company went bankrupt or otherwise experienced financial distress.

Recent settlements and judgments obtained by the Labor Departments and through private litigation document that officers and other members of management participating, or possessing authority to influence, the handling of health, 401(k) and other pension, or other employee benefit plans regulated by ERISA may be exposed to personal liability if these benefit programs are not maintained and administered appropriately. This risk is particularly grave when the sponsoring company becomes financially distressed or goes bankrupt, as the handling of employee benefit and other responsibilities becomes particularly disrupted and the lack of company liquidity often leaves executives and service providers as the only or best source of recovery for government officials and private plaintiffs.

This reality is documented not only by litigation brought by the Labor Department and private plaintiffs in high profile cases like Enron, as well as a host of other less noticed actions. In recent months, the Labor Department has filed several lawsuits against business executives and businesses for alleged breaches of fiduciary duties. The Labor Department also has been successful in securing judgments or settlements against members of management accused of breaching ERISA fiduciary duties with respect to the handing of employee benefit responsibilities when their companies became distressed or bankrupt. On June 1, for instance, the Labor Department announced it had filed suit against BDH Clinical Research Services and its president, Basil Halliday, seeking to recover $37,031 in delinquent contributions to employees' individual retirement accounts with the company's savings incentive match plan (SIMPLE IRA).[iv]

Likewise, on May 15, the Labor Department announced that it has obtained a consent order in requiring Robert Chipley, Curtis Chipley and Wilbert Kang to pay $26,451 the Prime Service Group 401(k) plan and waive any benefits otherwise owed to them from the plan. The forfeited benefits and other amounts paid by the three former company officers will be used to restore employee contributions that their now-defunct telecommunications and networking business withheld from employees' paychecks but did not deposit with the employee benefit plan. The consent order in *Chao v. Chipley* resolves a breach of fiduciary duties lawsuit against the now-bankrupt company and its former officers in which the Labor Department alleged that the Chipleys and Kang breached their fiduciary duties under ERISA by failing to forward employee contributions.

The *Chipley* consent order announcement follows the May 1 announcement by the Labor Department of the entry of a consent order in *Chao v. Nations Financial Group Inc.*, which will require Nations Financial Group Inc., Seven Fields, and the trustees of its 401(k) profit-sharing plan to pay to the Nations Financial Group Inc. 401(k) plan. In *Nations Financial Group, Inc.*, the Labor Department sued Mark Damiani and Valerie Damiani for breach of fiduciary duties for failing to remit employee contributions and loan repayments deducted from employees' paychecks and failing to timely forward contributions and repayments from January 2002 through July 2005. In addition to ordering restitution, the judgment removes the defendants from service as plan trustees, requires them to pay $5,000 for the services of an independent fiduciary to terminate the plan, and permanently bars them from serving as fiduciaries of any other employee benefit plan.

The consent orders are only a few a rising number of enforcement actions taken against business executives, board members, plan vendors and others for alleged misconduct relating to the maintenance, administration and funding of various employee benefit programs regulated by ERISA. In April, for instance, the Labor Department sued now-defunct Rycor Fabrication LTD of Dayton and its former vice president, Steven Adams, for failing to administer and terminate the company's 401(k) plan so that assets could be distributed to participants. The lawsuit[v] alleges that Adams failed to carry out his responsibilities as plan administrator to terminate the plan and distribute its assets to beneficiaries and participants when the company ceased doing business. The suit seeks to appoint an independent fiduciary to manage the plan, terminate it and distribute the nearly $14,000 in assets to eligible participants and beneficiaries. In a separate action,[vi] the Labor Department also is suing the former president of Universal Aquarium Systems, Inc., Pedro "Peter" Escobal, and trustee Gayle Escobal, for breach of fiduciary duties in their handling of the 401(k) plan of their company in violation of ERISA. Meanwhile, the Labor Department secured an order in *Chao v. Wanda Robinson* requiring a District of Columbia medical practice and the former trustee of the corporation's pension and profit-sharing plans to pay $62,937 to those plans for failing to responsibly manage the employee benefit assets they hold in trust, failing to annually collect and remit required employer contributions owed to the pension plan, and failing to honor participant requests for distributions from both plans.

Sponsoring companies and their business leaders are not the only ones who face risks if financially distressed companies mismanage their employee benefit responsibilities. Employee benefit plan service providers such as banks, administrative service providers and the others involved in advising or assisting plan sponsors or others about the administration and design of the plan often become targets for fiduciary liability litigation under ERISA after the sponsoring company fails leaving employee benefit responsibilities unfulfilled or mismanaged. Other business partners also can face risks. For instance, because amounts deducted from employee pay for contribution to employee benefit plans are plan assets under ERISA, lenders, banks and other finance business partners need to exercise caution when administering lock box or other security arrangements to avoid taking possession or otherwise exercising control over plan assets in a manner that could give rise to fiduciary liability. Likewise, when business consultants and advisors, lenders or other business partners use contractual or financial power to control operations of a distressed operation, they should exercise caution to avoid undertaking management in a manner that could be construed as a functional exercise of discretionary control over employee benefit plans or their administration. Under ERISA, an individual who provides investment advice for a fee or otherwise exercises or has the power to exercise functionally other discretionary control over an employee benefit plan or its administration generally is considered a fiduciary regardless of whether that party has been formally named as possessing that power or has expressly disclaimed that power in written documentation.

The Labor Department enforcement activities in the first half of this year highlight the longstanding and ongoing policy of aggressive investigation and enforcement of alleged misconduct by companies, company officials, and service providers in connection with the maintenance, administration and funding of ERISA-regulated employee benefit plans. Labor Department officials report that these aggressive enforcement activities resulted in the recovery by the Labor Department of more than $1.4 billion related to pension, 401(k), health and other benefits from companies, company executives and others for alleged violations of ERISA in fiscal year 2006 alone. In addition to prosecutions brought by the Labor Department, companies and individuals that exercise discretion and control of the administration or funding of employee benefit plans regulated by ERISA also may be sued personally by participants and beneficiaries for breach of fiduciary under ERISA. A review of the Labor Department's enforcement record makes clear that where the Labor Department perceives that a plan sponsor or its management fails to take appropriate steps to protect plan participants, the Labor Department will aggressively pursue enforcement regardless of the size of the plan sponsor or its plan, or the business hardships that the plan sponsor may be facing.

A complex maze of ERISA, tax and other rules make the establishment, administration and termination of employee benefit plans a complicated matter. When the company sponsoring a plan goes bankrupt or becomes distressed, the rules, as well as the circumstances can make the administration of these responsibilities a powder keg of liability for all involved. Companies and other individuals that in name or in function possess or exercise discretionary responsibility or authority over the maintenance, administration or funding of employee benefit plans regulated by ERISA frequently are found to be accountable for complying with the high standards required by ERISA for carrying out these duties based on their functional ability to exercise discretion over these matters, whether or not they have been named as fiduciaries formally. Despite these well-document fiduciary exposures and a well-established pattern of enforcement by the Labor Department and private plaintiffs, many companies and their business leaders fail to appreciate the responsibilities and liabilities associated with the establishment and administration of employee benefit plans. Frequently, companies sponsoring their employee benefit plans and their executives mistakenly assume that they can rely upon vendors and advisors to ensure that their programs are appropriately established the establishment and maintenance of these arrangements with limited review or oversight by the sponsoring company or its management team. In other instances, businesses and their leaders do not realize that the functional definition that ERISA uses to determine fiduciary status means that individuals participating in discretionary decisions relating to the employee benefit plan, as well as the plan sponsor, may bear liability under many commonly occurring situations if appropriate care is not exercised to protect participants or beneficiaries in these plans. For this reason, businesses providing employee benefits to employees or dependents, as well as members of management participating in, or having responsibility to oversee or influence decisions concerning the establishment, maintenance, funding, and administration of their organization's employee benefit programs need a clear understanding of their responsibilities with respect to such programs, the steps that they should take to demonstrate their fulfillment of these responsibilities, and their other options for preventing or mitigating their otherwise applicable fiduciary risks.

Cynthia Marcotte Stamer recently discussed these risks and responsibilities in greater detail in an interview published in the December, 2006 edition of the ***401(k) Advisor***.[vii] If you would like additional information about these risks and options for their management, have other questions about your company's human resources, employee benefit or other operational risks or internal controls practices, or want to request publications, information about upcoming programs, or other materials, please contact: Cynthia Marcotte Stamer, P.C., Member, Glast, Phillips & Murray, P.C., 2200 One Galleria Tower, 13355 Noel Road, LB 48, and Dallas, Texas 75240. Telephone (972) 419-7188. E-mail cstamer@gpm-law.com.

We hope that this information is useful to you. If you or someone else you know would like to receive future Alerts or other information about developments, publications or programs, please be sure that we have your current contact information – including your preferred e-mail – by providing that information to us through registration on our website at Cynthiastamer.com or via telephone, fax or e-mail.

For other helpful resources and information about employee benefits and human resources matters, go to CynthiaStamer.com or contact

Ms. Stamer.

ABOUT CYNTHIA STAMER

Board Certified In Labor and Employment Law by the Texas Board of Legal Specialization, attorney Cynthia Marcotte has nearly 20 years experience helping employers and business leaders design, implement, administer and defend human resources and other internal controls, outsourcing and other external services arrangements, employee benefit and compensation, and other human resources management and legal risk management practices. Chair of the American Bar Association (ABA) Health Law Section Managed Care & Insurance Interest Group and the ABA Real Property, Probate & Trust Section Welfare Plan Committee, she is widely recognized for her experience and knowledge on health and other employee benefit, insurance and human resources matters. Her practice focuses on working with businesses to manage their people and processes to help the business prevent and solve problems and designing employee benefit and other compensation programs, practices and products; and manage risks and costs.

Recognized in the International Who's Who of Professionals and bearing the Martindale Hubble AV-Rating, Ms. Stamer is a highly regarded legal consultant, author and speaker, who regularly conducts management and other training on a wide range of employee benefit, human resources and internal controls, and other related risk management matters. She also serves in leadership positions in numerous human resources, corporate compliance, and other professional and civic organizations. For instance, in addition her many leadership roles in the American Bar Association, Ms. Stamer also serves the editorial advisory board of The Bureau of National Affairs, Inc. (BNA), Employee Benefits Library on CD and various other editorial advisory boards, is a past Chair of the Dallas Bar Association's Executive Compensation and Employee Benefit Committee, is a former Board Member and Continuing Education Chair of the Southwest Benefits Association, a former member of the Society For Human Resources Management's Consultants Forum and Region IV Boards, on the Board of Directors of the National Kidney Foundation of North Texas, and in leadership roles in various other professional, charitable and civil organizations.

Ms Stamer is the author of 100s of publications on a host of human resources and related issues. Her writings have appeared in a variety of other publications, including works published by the American Bar Association, Aspen Publishers, BNA, the American Health Lawyers Association, and Government Institutes, Inc. and others. For a listing of some of these publications, see cynthiastamer.com. Her insights on human resources risk management matters also have been quoted in The Wall Street Journal, various publications of The Bureau of National Affairs and Aspen Publishing, the Dallas Morning News, Spencer Publications, Health Leaders, Business Insurance, the Dallas and Houston Business Journals and a host of other publications.

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[i] *551 U.S. ___ (June 11, 2007).*

[ii] *In the first three months of 2007, business bankruptcy filings rose 60 percent and consumer filings increased by 70 percent, compared with the first three months of 2006, according to data collected by Jupiter eSources LLC, an Oklahoma City company that runs a bankruptcy database called Automated Access to Court Electronic Records, or AACER. See "Bankruptcy Filings Surged in Q1," Associated Press (April 4, 2007).*

[iii] *See, http://www.dol.gov/ebsa/newsroom/main.html.*

[iv] *Labor Department Release Number: 07-774-ATL (118)(June 1, 2007).*

[v] *Chao v. Adams.*
[vi] *Chao v. Universal Aquarium Systems 401(k) Plan.*
[vii] *See, "Enron litigation has implications for plan sponsors and management," 401K Advisor (December 1, 2006).*