



# ERISA CONTROVERSY REPORT

## Message From The Firm

*I thought long and hard about the unifying theme of the three articles in this newsletter—one relates to claims against a third-party administrator, one relates to claims against a registered investment adviser, and the third relates to claims against a plan sponsor. What triggered the litigation in each case differed, too. The first article involves a TPA who made statements in internal memos that came back to bite it (that is, it said too much). The second involves an RIA whose engagement agreement failed to point out which of its services were fiduciary services and which were non-fiduciary services (that is, it said too little). The third involves a plan sponsor that probably did everything right but still got sued. What binds the three cases together is, it is nearly impossible to prevent disputes from occurring in the real world. You might do too much. You might not do enough. You might get sued through no fault of your own. Since no one can plan for every contingency, anyone who sponsors an employee benefit plan or provides services for plans should consider protecting themselves with insurance. And, if litigation comes, we're here to help.*

*Joe Faucher  
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## Today's File Memo is Tomorrow's Evidence



*By Joe Faucher (JoeFaucher@Reish.com)*

Over the years we have represented numerous retirement plan service providers in litigation matters with tremendous success. But even with our collective years of experience and our knowledge of the law that governs claims against service providers, it isn't always easy for service providers to escape liability. The facts of each case dictate whether we are able to engineer an early exit from litigation for our clients. Sometimes, our clients' own words regarding the services they provide make the difference.

In one case we handled, our clients—employees of a corporation that provided third party administration (“TPA”) services—purchased the shares of the company from the prior owner. The prior owner had become more interested in selling investment products. While the prior owner was in charge, he steered some of his plan clients to a real estate syndicator/developer. When the real estate market suffered a downturn, it became apparent that the developer was engaged in a Ponzi-type scheme—paying long-time investors with new investors' money.

By the time the scheme came to light, our clients had purchased the stock of the TPA firm. In ordinary circumstances, the fact that the company—through the prior owner—had put the plans and the developer together may have been a relative non-issue. However, two facts made this situation different from “ordinary circumstances.” First, in an internal memorandum from the prior owner of the TPA firm to another employee, the prior

owner noted that one of the plan sponsors would sign “anything I tell him to sign.”

This statement suggested that the plan sponsor may have abdicated control over the plan—and possibly over its investments—to the prior owner. In other words, the statement could be construed to mean that the prior owner exercised discretionary authority or discretionary control regarding the management of the plan, or authority or control respecting management of its assets. Why does that matter? Typically, TPA firms who perform “traditional” TPA functions (calculating contributions, preparing forms 5500 and providing recordkeeping services) are not considered plan fiduciaries. However, ERISA is clear that those who exercise discretionary authority or control over the management of a plan or any authority or control over its assets, are fiduciaries—at least to the extent they perform those functions. To the extent they, provide those functions, they can be held liable for breach of their fiduciary duties.

The other fact that distinguished this case from the typical case is that the prior owner received undisclosed compensation from the real estate developer for referring investors to the developer. Since the plan sponsors were not aware of the compensation, they did not have an opportunity to approve or disapprove of it. If one could assume that the prior owner could reasonably be found to be a fiduciary, it would also be reasonable to conclude that he breached his fiduciary duty by effectively determining his own compensation.

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## RIAs: Fiduciaries for What?



By Fred Reish ([FredReish@Reish.com](mailto:FredReish@Reish.com))

I recently served as a consultant and expert witness in a lawsuit against an RIA—registered investment adviser. More technically, I was the expert hired by the attorney for the IAR—the individual adviser representative. The broker-dealer/RIA had separate legal counsel and a separate expert.

The adviser was sued as a fiduciary for recommending a recordkeeper. Because of problems with the recordkeeper, the plan lost several hundred thousand dollars. Unfortunately, the recordkeeper went out of business and the plan was “left holding the bag.” That is, the plan was not able to recover the losses from the culpable party—the recordkeeper.

The adviser had an agreement with the plan that described the services to be provided. The agreement also acknowledged that the adviser would be a fiduciary. However, most of the services were not fiduciary services. In fact, the only fiduciary service was assistance with the selection and monitoring of the investments. Unfortunately for the adviser, though, the agreement could be interpreted to say that the adviser was serving in a fiduciary capacity for all of the services (which would include help in the selection of other service providers, investment education for participants, responding to questions about the plan, and so on). But, under the law, none of those services are fiduciary in nature.

As you might imagine, the plan’s attorney alleged that the adviser and the broker-dealer/RIA were fiduciaries for all of the purposes listed in the agreement. In other words, the attorney asserted that the prudent man rule, and the ongoing duty to monitor, applied to the help with the selection and oversight of the recordkeeper. My expert testimony, both in my report and at deposition, was that the adviser was not, and could not, be a fiduciary for selection of the recordkeeper.

In any event, because of the confusion about the meaning of the agreement, and the resulting risk of litigation, the case settled. While I do not know the settlement amount, I would not be surprised if the attorneys’ fees, expert witness expenses, court costs, deposition fees, and so on, were over \$100,000. And, I suspect that there was a similar cost for the broker-dealer/RIA.

From my perspective, the moral of this story is two-fold. The first is that service agreements for RIA firms need to be well drafted. While that encompasses a number of issues, this case illustrates that the agreements should clearly distinguish between those services that are fiduciary in nature and those that are not. Once that distinction has been made, the agreement can further impose restrictions on liability for the non-fiduciary services. For example, the agreement could limit the liability for non-fiduciary services to the fees charged for them, to a stated dollar amount, or to damages resulting only from gross negligence or willful misconduct. However, fiduciary services cannot have those restrictions because of the ERISA prohibition on exculpatory clauses.

Secondly, the case demonstrates the cost and complexity of fiduciary litigation. For example, it can be difficult to prove—or disprove—fiduciary status. Then, once fiduciary status is established, there can be controversy over whether a particular activity is a fiduciary function. Finally, it is difficult and time-consuming to prove, or disprove, what is prudent in a given situation, particularly when both sides have different recollections of the facts and when there is little in the way of written documentation.

Because of these issues, advisers need to be prepared for the high cost of litigation. Of course, fiduciary liability insurance is one way to do that. As a word of warning, don’t rely on your malpractice, or errors and omissions, insurance to guard you against fiduciary breaches. Most have specific exclusions from fiduciary coverage. ❖

## Tomorrow’s Evidence

*continued from page 1*

The law is clear that persons are only fiduciaries “to the extent” they exercise a fiduciary function, and it is far from clear that the former owner in this case actually exercised control over plan assets. Nevertheless, the evidence in the file would have caused challenges in the litigation and made it very difficult for our clients—who inherited the liability of the TPA firm—to quickly escape liability. The matter ultimately settled.

The case teaches several lessons. First, it rarely does any good for plan service providers to make grandiose statements about the services they provide, even in internal memos.

**Internal memos in the ordinary course of business become evidence once litigation is commenced.**

In this example, the internal memo created the specter that the TPA firm could be subjected to fiduciary liability. Second, managing risk requires business owners to seek legal counsel when they buy an ongoing business concern. In this case, a properly drafted purchase agreement could have allowed the TPA firm’s new owners to avoid any entanglement in this rather messy litigation. Third, and perhaps most importantly, plan service providers—including TPAs, registered investment advisers and independent adviser representatives—need to understand that even diligent risk management efforts can’t prevent others from filing lawsuits. As a fallback, anyone providing services to a plan needs to review whether they have adequate insurance coverage. Because standard errors and omissions insurance may not provide coverage for claims of breach of fiduciary duty, service providers need to analyze the services they perform and decide whether they need coverage that will protect them in the event of a fiduciary breach claim. ❖

## Responding to Participant Requests for Information



*By Joe Faucher (JoeFaucher@Reish.com)*

The Employee Retirement Income Security Act of 1974 (“ERISA”) regulates how employers respond to requests for plan-related information by participants and beneficiaries. No request for information should be taken lightly. We have represented many companies who have been sued over how they responded—or did not respond—to participants’ requests for information about a plan.

In one recent case we handled, a participant claimed she asked for information about early retirement benefits. The employee was already receiving benefits under a disability benefit plan sponsored by the company. She claimed that she asked questions about whether receiving early retirement benefits would adversely impact those disability benefits and was told that receiving early retirement benefits would have no effect on her disability benefits. In fact, under the disability plan, the early retirement benefits offset those disability benefits. The participant claimed that had she known that, she would not have elected to begin receiving the early retirement benefits, but instead would have waited until her normal retirement date.

A dispute arose over whether the participant actually asked specific questions about the relationship between the two plans. Regardless of whether any such conversation ever took place, we argued that the retirement plan itself was clear that, once a participant elected to begin receiving retirement benefits, the election could not be reversed (and that the disability plan spelled out the offset). The participant sued the company, claiming that she received erroneous advice.

We argued that absent extraordinary circumstances, and unless the employer

is interpreting an ambiguous plan term, it cannot be liable to participants and beneficiaries who claim to have relied on the purportedly bad advice. So, although there was a dispute about whether the employer actually gave the advice that the participant claimed it did, it didn’t matter because there was no ambiguous term in the plan. And, in any event, the participant admitted that her discussions with the employer did not relate to any specific provision in the plan document—in fact, she admitted she never looked at the plan document during the course of her discussions with the employer.

Fortunately for our client, the court agreed with our arguments, holding that the case did not involve the extraordinary circumstances required for an employer to be held liable for giving allegedly incorrect advice about plan benefits. In other words, an employer’s oral statements about what the plan provides or doesn’t provide generally cannot be used to accomplish a result other than what the plan itself actually requires.

Although the case had a happy outcome for our client, it still teaches several lessons. First, employers should have a plan in place for fielding inquiries from participants. Although the law favors plan sponsors with respect to claims that they gave improper advice, there are exceptions to the general rule. Whenever a participant asks for information regarding plan benefits, the most prudent course of action is to direct the participant to the plan document.

The law also requires plan administrators (in many cases, the plan sponsor) to provide certain documents to participants and beneficiaries “upon written request.” Some documents required to be produced—the latest updated summary plan description and annual report—are easy to identify. However, the law also requires administrators to provide

“other instruments under which the plan is established or operated,” and has effectively left it up to the courts to decide whether the documents requested in a given case fall into that category.

Failure to timely provide documents in response to such a request can give rise to significant monetary penalties. Consequently, any time a participant requests—particularly in writing—plan-related documents, plan sponsors should be sure to respond promptly and fully. If there is ever any question whether the employer is obligated to produce the requested documents, it should promptly seek advice from a qualified employee benefits attorney. ❖

### Western Pension & Benefits Conference

Heather Abrigo, as a member of the Program Committee for the Annual Western Benefits Conference invites everyone to attend a unique and informational educational experience. The Annual Western Benefits Conference will be held this year from July 28, 2009 through July 1, 2009 at Denver, Colorado. The 2009 Western Benefits Conference is a joint conference, combining the ASPPA Summer Conference and Western Pension & Benefits Conference Annual Meeting to provide two great conferences in one. This conference is designed to accommodate retirement, health, welfare and benefits professionals.

On Monday, June 29, Bruce Ashton, who currently serves as the president of the Western Pension & Benefits Conference Los Angeles Chapter, will present a session entitled “Fiduciary Worst Practices.” On Wednesday, Bruce Ashton will also present a session entitled “Hard times/New Challenges.” For more information about the conference e-mail [conferences@asppa.org](mailto:conferences@asppa.org). or e-mail [heatherabrigo@reish.com](mailto:heatherabrigo@reish.com).

## Commentary on Retirement Events



By Fred Reish ([FredReish@Reish.com](mailto:FredReish@Reish.com))

The New York Attorney General, the California Attorney General and the SEC are investigating “pay-for-play” for public pension plans . . . the hedge fund scandals have caused significant losses to retirement plans . . . retirement plan losses are staggering and litigation is on the upswing.

Why is that happening?

The answer is . . . it’s because that is where the money is . . . retirement plans are nothing but large pools of money—partially in cash and largely invested. As a result, retirement plans are the victims of all kinds of fraud and abuses, with the most common being excessive fees.

Unfortunately, though, while the perpetrators—consultants, brokers,

advisers, investment managers—are sued and prosecuted, the innocent, but inattentive, fiduciaries and service providers are also sued. So, while the active perpetrators cause the damage, the passive fiduciaries and advisers who did not stop the perpetrators are victims twice over. First, they are responsible for fixing the problem and, secondly, they may be held liable for putting the money back in the plan.

Because of these factors, it is inevitable that many fiduciaries and many service providers will be sued each and every year.

The moral of this story is two-fold. First, fiduciaries and advisers need to be aware of, and attentive to, the opportunities for fraud and abuse, and need to have practices and procedures in place to stop them. “Trust” is not enough. To paraphrase President Reagan, you need

to trust, but verify. Secondly, you should consider appropriate insurance. The amount of the insurance varies from person to person. My personal thinking is that, to appropriately manage the premium cost, you should have a fairly high deductible with mid-range policy limits. (By “mid-range,” I am referring to an amount that would, at least, cover most of the claims that will likely be asserted against you, together with the defense cost. In other words, from a cost-benefit perspective, you may not want to pay for insurance that would cover the worst imaginable claim.) With regard to a high deductible, I would recommend a deductible that is no higher than the amount that you could reasonably absorb as a business expense. If you are a small business, that might be \$10,000 or \$15,000. If you are a mid-sized business, that might easily be \$100,000 or more. The deductible is a particularly important factor in pricing the premium cost of insurance; as a result, it should be as high as you can reasonably bear. ❖

### Around the Firm

**Speeches:** On March 26th, **Joe Faucher and Mike Vanic** presented “Issues in ERISA Litigation: Settlor Functions vs. Fiduciary Functions” to the Chubb Group of Insurance Companies in Los Angeles. On April 29th, **Jason Roberts** presented “What’s New with 401(k) Fiduciary Compliance” at the Intercare University’s Update on 401(k) Fiduciary Compliance Seminar in La Jolla and Carlsbad. At the fi360 Annual Conference, held on May 6th-8th in Scottsdale, AZ, **Fred Reish** presented a session on “New Laws, More Regulations and Fiduciary Trends: Where Are We Going?” and was a panelist for the sessions “Managing Risk with Improved Documentation and Business Practices” and “Reports of Target Date’s Death Have Been Greatly Exaggerated—Analyzing the Success of Target Date Funds.” **Jason** presented “Fiduciary Participant Advice (PPA): Can It Work in Your Practice and How Do You Manage the Fiduciary Liability?” at the conference.

**Quotes:** In the May 5th issue of *Pension & Benefits Reporter*, **Heather Bader-Abrigo** was quoted in the article “Sign of the Times: As Recession Pushes on, Employers Pull Back 401(k) Matches.” In the May 11th issue of *Fund Action*, **Jason** was quoted in the articles “Unpleasant Surprise may Loom in Fine Print of Andrews Bill” and “RIAs Taking on More Liability.”

**Articles:** In the April issue of the *Pension Plan Fix-It Handbook*, **Nick White** wrote the article “QDROs Are Not the Only Way for a Divorcing Spouse to Waive Pension Benefits.”

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