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ATTORNEYS AT LAW

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Message From The Firm

Perhaps not surprisingly, the articles in this edition of our newsletter discuss cases in which we achieved the best possible results for our clients. Nevertheless, there are lessons to be learned even if you win in litigation.

In the first article, Mike Vanic and I relay a story about a litigation matter we recently handled on behalf of a financial institution client. In that case, our client was dismissed from a lawsuit involving an alleged breach of fiduciary duty in connection with the investment of a retirement plan's assets.

In the second case, we obtained summary judgment for our client, a third party retirement plan administration firm. The case presents a good example of potential problems that might be encountered in terminating a defined benefit pension plan.

Our closely held business clients – the core of our firm's practice – want to know how to avoid litigation altogether. The true common thread in the cases discussed in these articles (other than the successful outcomes) is that with good planning, and a little luck, the lawsuits could have been avoided.

When litigation cannot be avoided, it is good to know that your lawyer is making all the right arguments to win.

I hope you find the articles interesting, and I welcome your calls and e-mails.

Joe Faucher
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Wanted: Someone to Blame

By Joe Faucher (JoeFaucher@Reish.com) and Mike Vanic (MikeVanic@Reish.com)

Significance: Clear communication–documented communication–is one of the best ways to avoid being sued. In this article, we discuss an ERISA litigation matter we recently handled, and how we were able to extract our client from a messy situation by pointing the court in the right direction from the very beginning.

Discussion: Our client, a large financial institution, acted as a "directed trustee" for a company's retirement plan. As the directed trustee, our client invested plan assets in the manner that its client instructed. With limited exceptions, it had no independent right to determine how to invest the plan assets.

However, the trust document itself was the only document that outlined our client's role in the investment process. The trust document, of course, is a fairly lengthy legal document. Unfortunately, many plan sponsors fail to take the time to read and fully understand those documents.

The plan sponsor was a family owned and operated business. The company president—the family matriarch—ran the business for many years. Although the company was required to designate an investment committee (which included the president and her brothers), the president made all the investment decisions during her lifetime. Our client offered, on several occasions, to provide investment advice for an additional fee, but the company president always declined. Her investment strategies paid off—for a time. After she died, however, the plan assets declined precipitously in value. As it turns out, nearly two-thirds of the plan assets were invested in the stock of a single insurance company.

The company president had designated her longtime companion as the beneficiary of her interest in the plan. A dispute later arose between the president's companion and her brothers regarding who was entitled to receive the matriarch's benefit under the plan. When it became clear that the parties would not settle the dispute, our client filed an interpleader action, and deposited funds equal to the value of the company president's plan benefit with the court. The court ultimately awarded the plan benefits to the company president's companion. When he learned how little

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Whose Job Is It Anyway?

The Extent of a Service Provider's Liability for Its Clients' Plans

By Joe Faucher (JoeFaucher@Reish.com)

Significance: In the real world, it would be almost impossible to find a retirement plan that doesn't have some problem. The laws that govern retirement plans are complex and ever-changing, and service providers must compile and distill huge amounts of information to do their jobs. Glitches are almost inevitable. Sometimes, they never make it to the surface. In other instances, like the case in this article, they come to light much later—and then the problem becomes much bigger. Fortunately, our story has a happy ending, at least for our client. It could have been even happier.

Discussion: We recently handled a litigation matter on behalf of a third party administrator of a defined benefit pension plan. Our client began providing services for the plan in the early 1980s, when it took over the administrative services from a large insurance carrier. Shortly before the switch, the plan made a partial distribution of benefits to approximately 20 plan participants, all of whom had already terminated employment with the plan sponsor. Each of those 20 participants had a small remaining benefit in the plan after they took their partial distributions.

When our client took over around 1984, it asked the plan sponsor to provide it with the names (and other pertinent information, such as birth dates, dates of hire, etc.) of all plan participants. There was nothing written in the file, however, to indicate exactly what was requested. What our client got back was the information regarding only active employees. The names of the 20 terminated participants were not included. (However, the names of those employees showed up in certain historical records that our client received from the insurance company/former plan service provider.)

About three years later, the company decided to terminate its defined benefit plan. Lump sum benefits were paid out to all of the plan participants *except* the 20 participants whose names were omitted from the list when our client came on board. The assets in the plan greatly exceeded the amount necessary to pay the present value of benefits owed to the participants. The excess reverted to the company. Some of that money should have been paid to the 20 "missing" participants. The company signed off on the amounts of the distribution owed to the participants, the benefits were distributed, and the plan was terminated in 1987.

All was well—until 2000—when one of the "missing" participants inquired about the remainder of her retirement benefit. When the plan sponsor realized what had happened, they made a demand upon our client to pay, among other things, all of the past due retirement benefits owed to the "missing" participants, plus interest on the funds that should have been distributed in 1987. The plan sponsor made this demand despite the fact that, at the time of the plan's termination, it had received a reversion of assets that was nearly *ten times* the amount that the plan sponsor would have paid in benefits to the missing participants when the plan was terminated—if they hadn't been forgotten.

The plan sponsor sued our client. In order to avoid the expense associated with a trial, we filed a motion for summary judgment, asking the court to award judgment in our client's favor. We made two primary arguments. First, we argued that the claim against our client was barred by the statute of limitations. The point of this argument was that the plan sponsor was in the best position to know who its plan participants were—especially those plan participants who terminated employment before our client began providing services. Therefore, since the plan sponsor should have known that the former participants were omitted from the termination calculations and should have received distributions at termination, any claim against our client for failing to account for the former participants was barred by the statute of limitations.

> *"...the difference between winning and losing in litigation often turns on whether the lawyer makes all the necessary arguments."*

The second argument was that the plan sponsor wasn't damaged. The gist of this argument was that our client never had any responsibility to pay benefits to anybody, and in any event, the plan sponsor had received a windfall when the plan was terminated, by receiving a reversion that included the amounts that should have been paid to the forgotten participants.

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SOMEONE TO BLAME

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the plan assets were worth, and the manner in which those assets had been invested before they were liquidated and deposited with the court, he filed a separate lawsuit against the company, the president's brothers (who were now in control of the plan), and our client, and sought to recover the difference between what he received, and what he might have received if the plan assets had been properly diversified. Alternatively, he sought the difference between what he recovered and what the assets might have been worth if the plan assets had been liquidated at the date of the president's death, and the resulting cash deposited in, for instance, a money market account.

We moved to dismiss the complaint against our client. The plaintiff ignored the fact that our client was, by the terms of the trust document, a directed trustee. He argued that our client had a greater responsibility—as a plan fiduciary—to ensure that plan assets were properly invested. We pointed to the trust—which the plaintiff had not attached to his own complaint—and persuaded the court that our client had no right or ability to determine how the plan assets were invested. (Not surprisingly, the company president's surviving brothers had pleaded ignorance regarding their own duties to the plan, and presumed that our client was in charge of deciding how to invest the plan's assets.)

The court agreed with our position, and granted our motion to dismiss. That turned out to be a very good thing. Eventually, the court awarded judgment against the president's surviving brothers, finding that they had a fiduciary duty to properly invest the plan assets, and had failed in that duty. In fact, they didn't even know they were fiduciaries. They were held personally liable for damages to the plan of nearly $1 million.

As good as the result was for our client, it is possible that litigation could have been avoided altogether. Plan and trust documents are lengthy and legalistic. Although plan sponsors and fiduciaries really should read them, and understand what they mean, the truth is that they sometimes—perhaps usually—do not. To make matters worse, "directed trustees" have come under attack in several recent court cases. Most recently, the plaintiffs in the Enron 401(k) plan litigation have argued that the trustee in that case is not a directed trustee at all, but rather a trustee with the fiduciary duty to oversee plan investment decisions.

In this climate, financial institutions that act as directed trustees should consider sending annual reminders to their clients that notify them of their limited role as directed trustees. A simple, clear, one-page document that annually reminds plan sponsors that they (and not the financial institution) are in charge of their plans' investments could prevent attacks on directed trustee status without having to refer to a lengthy plan document that the plan sponsor may never have carefully read in the first place.

Conclusion: The only thing better than winning a lawsuit is not getting sued at all. Any financial institution—or any benefit plan service provider for that matter—should consider implementing systems that will decrease the likelihood of getting sued. Those same systems may have the additional benefit of forcing plan sponsors to pay greater attention to their own plans, and to take the steps necessary to protect their employees' retirement benefits. ❖

WHOSE JOB IS IT

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The court granted our motion for summary judgment, finding that the statute of limitations barred the claim. This result saved our client the significant expense associated with having a trial. At the motion hearing, however, the court indicated that it disagreed with our argument regarding whether the plan sponsor had sustained damages. The judge held that, despite the fact that the reversion the plan sponsor received included the benefits that should have been paid to the forgotten participants, the plan sponsor may have sustained damages. We mention this to point out that the difference between winning and losing in a litigation matter often turns on whether the lawyer makes all the necessary arguments.

Conclusion: Although our client was victorious in this case, it's yet another example of one that might have been avoided altogether. It was very difficult to tell exactly what information our client had requested from the plan sponsor back in 1984, because the requests were largely oral, rather than in writing. While it was assumed that our client asked for information regarding *all* participants (rather than just *active*) participants, there was no documentary evidence of that fact. Therefore, we had to demonstrate that, even if our client *did not* ask all the right questions, the plan sponsor still knew everything it needed to know to determine that some of its terminated participants were being left out of the mix.

Plan service providers should take the time to implement procedures that will avoid this kind of problem. ❖

Around the Firm

Speeches: In February, Marty Heming gave a presentation on the topic of "Fiduciary Responsibility" to a pension administration group. He also presented a seminar to pension administrators on the topic of "Controlled and Affiliated Service Groups." Fred Reish spoke at ASPA's 401(k) Sales Summit conference in Scottsdale, Arizona on March 1st on the topic "Can Sales Become Advice?—When It Can Help and When It Can Hurt."

Quotes: Fred was quoted in the January issue of *Employee Benefit News* in "ERISA Lawyers Urge Caution on Default Investments." Bruce Ashton was quoted in the February issue of *Plan Sponsor* magazine in the article "Running the Fund: Certify Able—Recent 401(k) Debacles Help Prompt the DOL to Look at the Need for More Education."

Articles: Joe Faucher authored an article on "Limitation of Liability Provisions in Service Provider Contracts" for the November-December issue of *The ASPA Journal*. Joe and Fred co-wrote an article for the December issue of *Employee Benefit Plan Review* on "ERISA Section 404(c): An Insurance Policy for Fiduciaries."

NOW AVAILABLE

PARTICIPANT DIRECTED INVESTMENT ANSWER BOOK

Fred and Bruce co-wrote the recently released third edition of the *Participant Directed Investment Answer Book*, published by Aspen Publishers. The book provides an in-depth look at the issues unique to participant directed plans, including 404(c), fiduciary requirements for the plan sponsors, investment issues and concerns arising out of Enron and similar cases.

To purchase this book, go to our firm web site at www.reish.com and click on the link under Spotlight, or call 1-800-447-1717.

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