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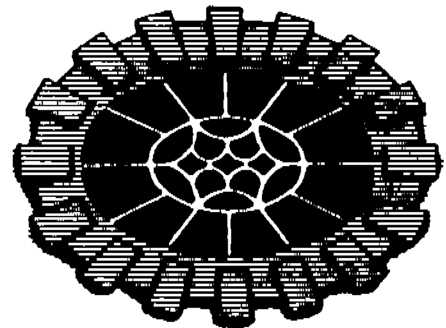
SOLUTIONS



Creative Risk Management
The McLaughlin Company

They'll See You In Court

Have you noticed an increase in the number of lawsuits brought by employees and former employees against trustees and other fiduciaries of employee benefits plans? We have. Four rulings have recently come down from the U.S. Supreme Court and other cases may be headed in that direction. Two cases addressed employer misrepresentation of benefits. The third case was an age discrimination suit. The fourth involved the waiving of an employee's right to sue in exchange for enhanced early-retirement benefits.

We found numerous websites of plaintiffs' law firms attempting to net disgruntled employees and former employees

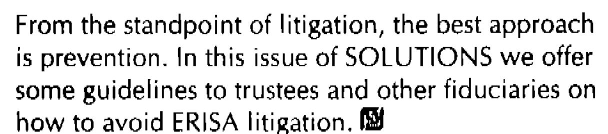
While these landmark cases made the headlines, there are hundreds of cases that do not. In those cases the leading allegation (about 45%) is denial of benefits. Administrative errors in plan benefits account for 18% of cases filed and improper advice of counsel is involved in 13% of the lawsuits. Other causes of action include allegations of misleading representation, wrongful termination of plans, discrimination, conflict of interest and imprudent investment.

We wondered what was behind this upsurge in litigation involving employee benefit plans. Could it be attributed to a change in corporate values? Was it the intricacy of the laws? Could it be blamed on baby boomers approaching retirement age? We decided to find out. Our research took us to the Internet. While surfing through the sea of cases we found what may be a clue to the rising tide. We came across numerous websites of plaintiffs' law firms attempting to net disgruntled employees and former employees. These sites profess to offer "ERISA Law Information" but really proffer representation - in most cases on a contingency basis. One firm expounds "ERISA is perhaps one of the biggest successful con jobs affecting the American working persons since the end of the Great Depression....If you are about to apply for benefits ....be aware that you are entering a legal mine field. If you do not wish to walk alone, contact me."

IN THIS ISSUE we offer some advice on how you can avoid "seeing them in court"

Staying out of Trouble
Are you an ERISA Fiduciary?
Understanding your Insurance Coverages
Alternative Dispute Resolution

Fiduciaries can take steps that will lessen the possibility of either becoming a target of an ERISA lawsuit.



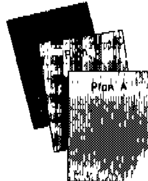
From the standpoint of litigation, the best approach is prevention. In this issue of SOLUTIONS we offer some guidelines to trustees and other fiduciaries on how to avoid ERISA litigation.

Top 10 Ways to Get in Trouble

By Kathleen M. Meagher, Landels, Ripley & Diamond, LLP
(Reprinted from San Francisco Attorney)

Everyone agrees that the rules governing employee benefit plans are too complicated. Most employers want to provide retirement, health and other benefits to their employees, but to do so legally and to receive the maximum tax advantage, employers must negotiate a sometimes bewildering maze of regulations. Here is a list of ten major benefits blunders, and suggestions about how to avoid them.

#10
Maintain an ERISA-Covered Plan without Knowing It.



The Employee Retirement Income Security Act of 1974 ("ERISA") covers welfare and retirement plans. Many employers do not know that most severance and salary continuation plans are covered by ERISA's welfare plan rules.

For all welfare plans, ERISA requires a plan document, a summary plan description and, if there are more than 100 plan participants, an annual report to the IRS. Failure to file the reports can result in very substantial penalties. Failure to maintain a plan document and summary plan description that spell out eligibility, payment amounts, and limitations on benefits can lead a court to interpret the plan in a way that is far more generous that the employer intended. On the other hand, a carefully written welfare plan permits the employer to limit benefit payments to exactly those situations and those amounts that the employer chooses.

#9
Don't Take Responsibility for Retirement Plan Investments

For virtually every employer-sponsored retirement plan, it is the employer who has ultimate legal responsibility for investment of plan assets. Employers should not assume that brokers or other investment advisors are liable as fiduciaries for investment losses. Only an "investment manager" under ERISA, who has agreed in writing to be an ERISA fiduciary, can relieve the named fiduciary from liability for investment decisions.

Even when participants may direct investment of their accounts–a very popular feature in 401(k) plans–the employer still bears the ultimate responsibility for selecting the investment choices offered and for complying with the rules for informing participants about those choices. *(See **Solutions,** Volume 3 Issue 4, "Avoiding Liability for Investment Advise.")*

Every employer who sponsors a retirement plan should set up a fiduciary compliance program, first adopting a set of investment guidelines, including a clear statement of each party's investment responsibility and authority, and second, establishing, and sticking to a schedule for monitoring investment performance.

8
Keep Former or Inactive Employees on Your Medical Plan without Telling your Insurance Company.

No good deed goes unpunished–helping out former employees by keeping them on the company health plan may lead to liability. Many health plans have an "actively at work" requirement, to which COBRA coverage is the only exception. If a former employee who is not actually eligible for coverage is kept on the plan, the insurance company may refuse to pay for medical expenses or the employer may be liable to the insurance company for expenses that were paid before the insurance company discovered the former employee's inactive status. Always check with the insurer before doing such a "favor" for a former employee, or cover him or her under COBRA. The employer can always help out a former employee by paying for all or a portion of the COBRA premium.

#7
Exclude Part-Timers from Your Retirement Plan.

Employers may exclude certain classifications of employees – for example, hourly paid employees – from eligibility for retirement plans, as long as mathematical coverage tests are satisfied. However, plans generally cannot require more than 1,000 hours of service within one year for plan participation. According to the IRS, this rule means that a plan may not have a blanket exclusion of part-time employees, even if the coverage tests are satisfied.

Although this rule has been in the retirement plan regulations for many years, it has largely been ignored. Last year, however, the IRS reminded employers about the rule and indicated that it would be on the lookout for violations. Employers who have a policy of excluding part-timers from all benefits programs will probably need to make an exception to that policy in the case of retirement plans.

#6
Be Careless about COBRA.

The courts have been notably pro-employee when presented with claims under COBRA, the federal law that requires most employers to offer continued health coverage after the employer's health plan coverage would otherwise end. Some courts have seized upon minor errors in COBRA's complex notification requirements to hold employer's liable for former employees' medical expenses that night have been covered under COBRA.

The costs of sloppy COBRA compliance can be enormous. Employers should be meticulous in providing all COBRA notification and elections within the proper time periods. Follow-up letters (with carefully filed copies) should be sent in all cases where former employees fail to respond to COBRA notices or fail to pay for elected COBRA coverage.

#5
Cut Corners on Plan Administration.

Proper administration of retirement plans takes time and expertise, and the cost can be shockingly high. If you have a complicated plan that requires numerous tests and calculations, or if the primary goal is to benefit the top executives, you should be prepared for high administrative costs. Incompetent or inadequate plan administration can cost much more – additional contributions to the plan, plus a stiff fine to the IRS.

In choosing a record-keeper for any retirement plan, be sure you have confidence that the record-keeper knows what it is doing. Be prepared to pay enough to compensate the record-keeper for good work – generally, you will get what you pay for.

#4
Adopt the Wrong Retirement Plan.

Do not let yourself be rushed into a retirement plan that may not be the right one. 401(k) plans, for example, are heavily marketed as a simple retirement plan solution for small employers, yet they are complicated and often expensive to administer. A small employer seeking a "no-frills" approach might be better off with a simplified employer pension ("SEP"). An employer that wants to benefit owners and executives as much as possible may want a combination pension and profit-sharing plan that has a higher contribution rate for pay above the social security wage base.

Always assume that the buck stops with you.

You should consider your options carefully – ask questions and seek second opinions – before the plan is adopted. In addition, you should read the plan carefully (laying in a supply of strong coffee, if necessary) to make sure it says and does exactly what is required, no more and no less.

#3
Don't Have Welfare Plan Documents that Protect You from Liability.

Most employers who provide health insurance or HMO coverage assume that the insurance contact or HMO agreement, plus the employee booklet describing benefits, are all the documentation they need. This could be an expensive mistake. These documents rarely contain language concerning the employer's liability as plan sponsor under ERISA and, more important, limiting that liability. For example, if insurance coverage is provided, the employer undoubtedly wants to be sure that it is not liable for expenses that the insurance company refuses to cover. A plan document can limit plan benefits to those that the insurance company is willing to pay. The employer also wants to be sure it has the right to terminate and change the welfare plan–ERISA requires that this be spelled out in the plan document.

As with investment responsibility, employers should have a clear understanding of who has ultimate responsibility for determining benefit claims. If the employer is the final decision-maker on appeals of welfare benefit denials, the employer should be aware of it and act accordingly to make sure that the

insurance company or other claims administrator really does consult with the employer. If the employer does not have ultimate decision-making power, the plan document or a separate contract with the administrator should so provide.

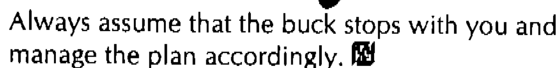
#2
Ignore Related Businesses When Designing Retirement Programs.

Many employers have interests in a number of business–limited partnerships and sole proprietorships as well as corporations. These employers can come to grief if a retirement program is designed for one business without taking the other businesses into account.

The tax rules for retirement plans require that a controlled group of businesses must be treated as a single employer for many of the plan discrimination rules. This means, for example, that a sole proprietor who also owned 80% of the stock in a corporation would not be able to have a Keogh plan for herself without also covering employees of the corporation.

Some plan consultants and sponsors of off-the-shelf prototype retirement plans may not delve deeply enough into an employer's corporate structure and possible related businesses. Every employer who owns an interest in another business should bring that interest to the attention of plan advisors and demand a careful analysis of the impact of the controlled group rules on the retirement program.

#1
Assume Someone Else is Liable for Errors and Fiduciary Breaches.



Always assume that the buck stops with you and manage the plan accordingly.

Even if you avoid liability for investment advice, you still have a fiduciary obligation under ERISA to manage your plan prudently and in the best interests of its participants. Some legal experts and insurance professionals have warned us to expect an upsurge in the number of lawsuits alleging poor investment decisions.

The number of fiduciary liability claims has already started climbing for many reasons:

- ⇒ **Baby boomers are beginning to worry about the size of their retirement savings.**
- ⇒ **Benefit laws are becoming increasingly complex.**
- ⇒ **Congress and the courts are turning up the heat on employer-sponsored retirement plans.**
- ⇒ **The investment marketplace is rapidly changing, focusing on individuals.**

How can you protect yourself?

CONSIDER LIABILITY INSURANCE. A $1 million policy costs about $2,000 per year.

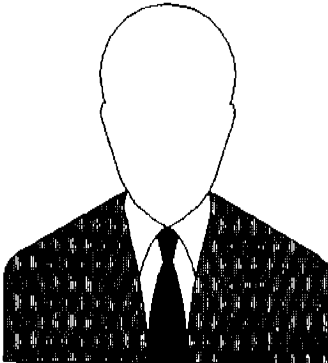
GET EXPERT HELP. We can recommend qualified experts who know the ins and outs of ERISA. Base compliance audits can run from $500 to $700. A review by an ERISA lawyer will cost about $2,000.

HELP EMPLOYEES MAKE BETTER INVESTMENT DECISIONS. Offer retirement planning and training and make educational materials available. Be careful, however: Never appear to give employees investment advice.

Are you an ERISA Fiduciary?

Are you a fiduciary? Are your personal assets at risk? Are you subject to law suits, fines, and penalties? Many people are and do not know it.

The rules and regulations of the Employee Retirement Income Security Act of 1974 (ERISA) include very strict guidelines for fiduciaries of plans that fall under ERISA control. Some of the plans that are subject to ERISA regulations include the following:



- ⇒ Pension plans
- ⇒ Profit-sharing plans
- ⇒ Thrift and savings plans (such as 401k plans)
- ⇒ ESOP's
- ⇒ Apprenticeship and Training Funds
- ⇒ Welfare plans (such as life insurance, hospital and medical insurance, disability insurance, and prepaid legal services)

ERISA's definition of an employee benefit plan is very broad and can include any plan, fund, or program established or maintained for the purpose of providing employee benefits to its participants or their beneficiaries.

Who are the fiduciaries of these plans?

According to ERISA, a fiduciary is any person so named in a plan or any person who exercises any discretionary authority or control with respect to the management or administration of the plan or its assets. This will normally include the plan sponsor, the plan administrator, trustees, and investment managers along with any other persons, including employees who are involved with any aspect of handling the plan or its assets.

Strict standards are in place for fiduciaries and any breach of their responsibilities can result in lawsuits and statutory penalties. A lawsuit against a fiduciary can be filed by the Secretary of Labor, any plan participant or beneficiary, or by another plan fiduciary. The Treasury Department and the Pension Benefit Guarantee Corporation can also impose penalties or bring lawsuits against plan fiduciaries.

Under the law, a fiduciary can also be held liable for the acts of a co-fiduciary. This means that the plan sponsor and individual fiduciaries can be subject to claims that arise out of the actions of various organizations that provide services to the plan. These can include consulting firms, professional administration firms, investment management companies, accounting firms, or law firms.

Individual fiduciaries are held personally liable for plan losses resulting from their breach of duties which can result in serious personal financial consequences.

According to ERISA, a fiduciary is any person so named in a plan or any person who exercises any discretionary authority or control with respect to the management or administration of the plan or its assets.

Are You Properly Insured?

In the event you must face litigation, you want to be sure you have the proper insurance and that your insurance policies responds as intended. The problem is that while benefit plans are diverse, there is a tendency is to treat them all the same when it comes to insurance.

Most plans have the requisite bonding coverage, some have fiduciary liability insurance, but most do not realize they may face other significant exposures. A problem arises when plans that have these exposures have no insurance to cover them.

BONDING REQUIREMENTS UNDER ERISA

According to the law, all fiduciaries and persons who handle plan funds or other plan assets are to be bonded for 10 percent of the aggregate amount handled, with a minimum bond of $1,000 and a maximum bond of $500,000. ERISA states in part, that:

> *"Every administrator, officer and employee of any welfare benefit plan or of any employee pension benefit plan subject to this act who handles funds or other property of such plan shall be bonded as herein provided..... Such bond shall provide protection to the plan against loss by reason of acts of fraud or dishonesty on the part of such administrator, officer, or employee, directly or through connivance with others."*

The term "fraud or dishonesty" encompasses such matters as larceny, theft, embezzlement, forgery, misappropriation, wrongful abstraction, wrongful conversion, willful misapplication or any other fraudulent or dishonest acts.

It should be noted the ERISA bond provides no coverage for individuals who are known to have committed illegal acts. Convicted felons and individuals disciplined for acts as minor as pilfering are not covered. Therefore, if the fund wishes to retain individuals who have committed "illegal acts" and still meet federal ERISA requirements, no such individual may handle any pension or employee welfare plan funds.

FIDUCIARY LIABILITY INSURANCE

The fiduciary liability policy provides protection for losses that the insured is legally obligated to pay because of a claim made for a wrongful act. By most policy definitions, a wrongful act includes any violation of the responsibilities, obligations, or duties imposed on fiduciaries by ERISA, as well as acts, errors, or omissions involved in plan administration. The fiduciary liability policy excludes losses that are covered by other types of insurance, such as general liability, automobile liability, and workers compensation policies.

There is a lot of confusion regarding the differences between the fidelity bond that is required by ERISA, fiduciary liability insurance, and employee benefits liability insurance. The fidelity bond only applies to dishonest acts on the part of the plan trustees. Employee benefits liability insurance normally only applies to claims rising out of administrative errors and is very limited. Many insureds think that by having employee benefits liability coverage, they do not need fiduciary liability coverage. **That is definitely not true!**

BODILY INJURY/PROPERTY DAMAGE

Trustee and fiduciary liability coverage forms exclude coverage for bodily injury and property damage liability because coverage for most claims of this kind are more properly the subject of commercial general liability and umbrella liability insurance.

PERSONAL INJURY

Claims involving personal injury caused by libel, slander, false arrest, invasion of privacy, malicious prosecution, and other standard personal injury perils are excluded by trustee and fiduciary liability coverage forms.

WORKERS COMPENSATION

All fiduciary liability coverage forms exclude coverage for any type of obligation under workers compensation, disability, unemployment, or similar laws. This is because such exposures should be covered under workers compensation policies.

MOTOR VEHICLES, AIRCRAFT, WATERCRAFT

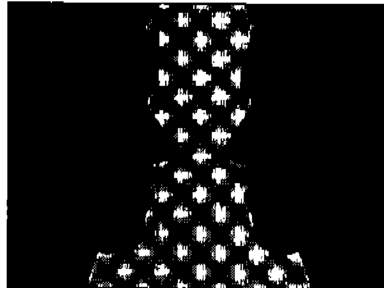
Liability arising out of automobiles, watercraft, or aircraft or any other type of motor vehicle is excluded by all fiduciary liability coverage forms.

Nothing can totally prevent law suits, but a **complete** insurance program can go a long way to limit your risk!

Alternative Dispute Resolution

Alternative Dispute Resolution (ADR) is the solving of conflict through means other than a trial before a judge or jury and without employing all the formal rules of evidence and procedure. ADR is generally an "alternative" to litigation.

Alternative Dispute Resolution is becoming an increasingly popular means to resolve disputes. ADR has often been described as a "'no-lose' alternative with a no-risk approach." It provides the parties an opportunity to discuss their problems candidly and facilitates their desire to reach a fair and lasting settlement. The success of ADR in resolving many types of legal disputes is evidenced by its growth and acceptance in corporate America. According to a 1993 survey conducted by Deloitte & Touche, corporate use of ADR has increased significantly.



Different degrees of formality have evolved that are faster and cheaper than reliance upon the traditional litigation system. ADR is now so widespread that attempts to negotiate cases are usually expected.

Arbitration is probably the oldest form of ADR, after direct negotiations. It involves the use of a neutral third party who essentially acts as a private judge. The arbitrator hears all sides of a dispute, reviews submitted evidence, and then issues a decision that is usually binding.

Arbitrations do not include juries and are conducted in less time than needed for a full-scale trial. Although the arbitration decision can be appealed to a master arbitrator or a court, this is uncommon. Arbitrations, barring exceptional circumstances, are meant to be final.

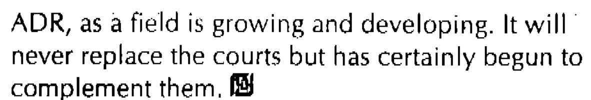
Another form of ADR is mediation. It is often confused with arbitration, although it has fundamental differences. Mediation is basically a process whereby a third party, usually an attorney, helps participants to discuss their differences with a view toward reaching a mutual agreeable settlement.

Unlike arbitration, mediation is usually not binding. The mediator does not render a decision or act like a judge. Instead, he or she works with all the participants collectively and separately to achieve a settlement, which may be voluntarily adhered to by all concerned.

The mediator does not command but persuades. Mediators try to focus on areas of agreement by the involved parties, thereby reducing areas of disagreement. Once issues in dispute are clearly defined, efforts are made to reach settlements on liability and damages.

Mediations have become popular because of their simplicity, flexibility, and voluntary nature. Participants maintain control in negotiations yet are able to confide privately to the mediator about strategy. During confidential discussions with a mediator, parties are more willing to make frank evaluations, which makes it easier to settle.

The two forms of ADR just discussed are by no means all of the options available. Variations on mediations, arbitrations, and mini-trials abound.



ADR, as a field is growing and developing. It will never replace the courts but has certainly begun to complement them.

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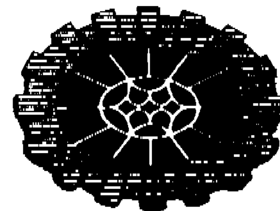

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