Mishandling Employee Benefit Obligations Creates Liabilities For Distressed Businesses & Their Business Leaders

Cynthia Marcotte Stamer, Esq.
Curran Tomko Tarski LLP
2001 Bryan Street
Suite 2050
Dallas, TX 75201

Business owners, executives, board members, and other business leaders of companies facing financial challenges should heed a mounting series of recent fiduciary liability settlement orders, judgments and prosecutions as strong reminders of the potential personal risk they may face if their health, 401(k) or other employee benefit programs are not appropriately funded and administered as required by the Employee Retirement Income Security Act of 1974, as amended (ERISA).

Businesses leaders struggling to deal with economic setbacks frequently may be tempted to use employee benefit plan contributions or funds for added liquidity or otherwise fail to take appropriate steps to protect and timely deposit plan contributions or other plan assets. A long and ever-mounting series of decisions demonstrates the risks of yielding to these temptations for businesses that sponsor these plans and the business leaders that make these decisions.

The mishandling of employee benefit obligations by financially distressed companies during the ongoing economic downturn is fueling an increase in Department of Labor Employee Benefit Security Administration (EBSA) 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.

EBSA enforcement activities during 2009 continue to 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. 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.

EBSA reports enforcing $1.3 billion in recoveries related to pension, 401(k), health and other benefits during fiscal year 2009. EBSA has filed numerous lawsuits to compel distressed companies and/or members of their management to pay restitution or other damages for alleged breaches of ERISA fiduciary duties, to appoint independent fiduciaries, or both for plans sponsored by bankrupt or financially distressed companies.

Recent settlements and judgments obtained by the Labor Department and through private litigation document that officers and other members of management participating, or possessing authority to influence, the handling of heath, 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.

In the December 2, 2009 decision in *Solis v. Struthers Industries Inc.,* for instance, a federal district judge ordered business leader Jomey B. Ethridge liable to pay $303,084.61 to restore assets belonging to the 401(k) plan of bankrupt Struthers Industries in an ERISA fiduciary responsibility action filed by the U.S. Department of Labor's Employee Benefits Security Administration (EBSA). Filed by the EBSA in the U.S. District Court for the Southern District of Mississippi, the *Struthers Industries* lawsuit alleged that Ethridge and Struthers Industries allowed employee contributions to be used for purposes other than providing benefits resulting in losses of $310,084.57. According to court documents, Struthers Industries designed and built heat transfer and pressure vessels at its Gulfport facility. In 2001, its 401(k) plan had 278 participants and assets totaling $8,279,083. The company filed for bankruptcy in 2003, and its assets were auctioned off in 2005. An independent fiduciary was appointed by the court in 2007 to manage the plan's assets. The ordered Ethridge personally to pay $303,084.61 in restitution to the plan for his involvement in the mishandling of the plan's assets. The order also bars Ethridge from acting as a benefit plan fiduciary in the future.

The *Struthers Industries* decision comes on the heels of EBSA's success in *Solis v. T.E. Corcoran Co. Inc*. last month in recovering more than $89,000 from business owners and operators found to have breached fiduciary duties to the participants of the T.E. Corcoran Co. Inc. Profit Sharing Plan by improperly loaning plan assets to he plan sponsor and an affiliated company. The Labor Department sued T.E. Corcoran Co. and its owners, John F. Corcoran and Thomas E. Corcoran Jr., alleging that the company and its owners caused the plan to lend money to the two companies at below market interest rates, without terms of payment and without documentation in violation of ERISA. The suit filed in the U.S. District Court for the District of Massachusetts, also named as a defendant Coran Development Co. Inc., a company co-owned by the Corcorans. T.E. Corcoran Co. Inc. was the sponsor and administrator of the plan, while John and Thomas Corcoran were trustees of the plan, making all three fiduciaries and parties in interest with respect to the plan. ERISA specifically prohibits the use of employee benefit plan funds to benefit parties in interest.

The *Corcoran* judgment requires that the plan account balances of defendants John F. Corcoran and Thomas E. Corcoran Jr. be offset in the amount of $89,273 plus interest to be allocated to the accounts of the other plan participants. The offset will make whole all of the accounts of the non-trustee participants. In addition, the court order appoints an independent trustee to oversee the final distribution of the plan's assets and the proper termination of the plan, requires the defendants to cooperate fully with the independent trustee in this process, and then prohibits them from serving as fiduciaries to any ERISA-covered plan for 10 years.

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 can be risky.

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.