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Unexpected Employee-Benefit Liabilities Cause Potentially Devastating Losses

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Although some of the liabilities that employee-benefit plans create for businesses are well known and appear on balance sheets, employers are often shocked by other unknown and unforeseen liabilities. Employers have found themselves faced with enormous unanticipated liabilities due to misunderstandings of who is in charge of various administrative functions for their employee-benefit plans, complex and often confusing federal requirements, increased scrutiny of qualified retirement plans by the Internal Revenue Service (IRS) and the Department of Labor (DOL), and increased focus by plan participants on benefit matters.

VIEWPOINT

Problems can arise in all different types of employee-benefit plans, leaving the employer ultimately responsible for enormous liabilities, such as:

- The trustee of a 401(k) plan may be personally liable as a fiduciary for investment choices if he or she fails to investigate a professional investment consultant's qualifications with due diligence, and that consultant chooses investments that are inappropriate for the plan.

- An employer can be liable for devastating medical bills if the third-party administrator of its health-benefit plan fails to provide proper COBRA notices to terminated employees and their beneficiaries, and the individual entitled to COBRA coverage is later injured during the COBRA continuation period.

- An employer can be liable for large tax penalties if the employer and the third-party administrator of its profit-sharing plan miscommunicate regarding which employees are eligible to participate in the plan, and the employer therefore improperly excludes certain employees from participating in the plan.

- An employer can be liable for a disability insurer's wrongful denial of a par-

ticipant's claim, if the employer is named as the plan administrator in the plan document, and the disability insurer may have no liability for its mistake.

As an employer maintaining benefit plans, it is important to recognize that federal law, under the Internal Revenue Code and the Employee Retirement Income Security Act (ERISA), sets forth a very comprehensive set of requirements for maintaining employee-benefit plans. These requirements vary based upon the type of plan at issue. However, some common requirements among various plans include not discriminating, intentionally or unintentionally, in the availability of benefits in favor of highly compensated employees, not excluding employees who are eligible pursuant to the terms of the plan document, and providing the proper notices to employees and former employees. It is also important to maintain clear and explicit plan documents so that no employee can argue that he or she was entitled to benefits under the terms of the plan following an event giving rise to an entitlement to benefits. If a plan document is ambiguous, it will be construed in favor of awarding benefits to the employee. Moreover, if the plan document and the Summary Plan Description (SPD) conflict, courts will often award benefits to the employee based upon the terms of the SPD.

Employers often enter into arrangements or agreements with third parties to administer their plans and rely on these third parties to avoid the pitfalls discussed above. Some of these third-party administrators may even supply all the legal documents to set up the plan. Typically, employers who maintain plans mistak-



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enly believe that the third-party administrator will be liable in the event that a participant is denied benefits wrongfully or tax-qualification requirements are not met.

However, often the third-party administrator may have absolutely no liability for problems that arise even though the third party administrator could have prevented or minimized the liability. This is due to several factors. First, ERISA provides that the party named as plan administrator in the plan document is liable to participants for any administrative failures. In most cases, documents provided by a third-party administrator name the employer as the plan administrator, even though the employer performs limited or no administrative functions for the plan. Moreover, many courts have interpreted ERISA to exonerate any parties not named as plan administrator even though they perform all administrative functions. Second, the agreements between the employers and third-party administrator or insurers are often short and generally place all final liability for plan failures on the employer and severely limit or eliminate the liability of the third-party administrator. These agreements are often signed without the advice of legal counsel and without any attempt at negotiating their terms, risking devastating effects. For example, small-business owners often set up 401(k) plans not only to benefit their employees, but also to save for their own retirement. They trust third-party administrators to correctly maintain their plans, only to find out that there have been failures to follow the rigorous requirements of the IRS. Addressing the failures may be very costly in terms of legal costs and corrective contributions. Ignoring the failures can result in a retroactive loss of the retirement plan's qualified status, potentially wiping out years of retirement savings for the owner of the business as well as the employees.

Fortunately, there are actions that an employer can take to reduce the risk of encountering such unanticipated liabilities

and avoid potentially devastating costs. Best practices include the following:

- Retain a third-party administrator with the expertise to correctly administer your employee-benefit plans;

- Treat the initial retention of a third-party administrator as you would any other large transaction, including appropriate due diligence;

- Negotiate, through an ERISA attorney, any and all agreements with a third-party administrator or insurer so that the terms of the agreements are as favorable

to you as possible;

- Utilize an ERISA attorney to review all plan documents at the inception of the plan, and review plan operations periodically;

- Maintain frequent contact with your third-party administrator to ensure mutual understanding of who is performing various tasks and of the operation of the plan;

- Involve an ERISA attorney immediately should a potential issue arise in the plan's administration; and

- Train human-resource employees in the proper operation of each of your various plans, and their responsibilities in administering the plans.

Employers should take a proactive approach to ensuring that their business does not experience such unexpected liabilities.

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