Practical Compliance With Bankruptcy Code Section 704(A)(11)

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Introduction

The Bankruptcy Abuse and Prevention Consumer Protection Act (BAPCPA) imposed many new mandates on bankruptcy trustees. Yet, in imposing duties on trustees to wind down an ERISA-governed plan, the bankruptcy trustee may seek to enjoy the benefits and protections of the bankruptcy court, including the derived judicial immunity they get when acting pursuant to court order. However, the trustee may be subject to the jurisdiction of the Department of Labor ("DOL") while performing the duties required pursuant to section 704(a)(11) of the Bankruptcy Code, 11 USC §704(a)(11). Trustees have not always been successful in their efforts to invoke the assistance of the bankruptcy court when dealing with ERISA-governed plans in the course of liquidating a debtor's estate. Until there is more judicial clarity, the safer strategy for the trustee is to terminate the plan using methods traditionally employed by ERISA professionals.

This article will first provide some background information on retirement plans and the DOL. Next it will discuss how the text of the statute appears to transform the trustee into an ERISA plan fiduciary and deprive him or her of the judicial immunities enjoyed under the Bankruptcy Code. It then examines the procedures of traditional ERISA professionals in search of a method by which the trustee can, to the extent possible, obtain judicial immunity for his or her involvement in terminating the retirement plan. Next it considers issues related to proactively interacting with the Department of Labor. Finally, it examines the current alternatives being considered by Congress.

Overview of ERISA-Governed Plans

The 401(k) plan is the most widely known ERISA-governed plan. (Other types include defined benefit plans and ESOPs.) These plans are governed by ERISA, the Employment Retirement Income Security Act of 1974, codified at 29 USC §1001 et seq., as well as a variety of provisions in the Internal Revenue Code. ERISA is administered and enforced by the Department of Labor and the Internal Revenue Service. Legislation and enforcement take place at the federal level.

The purpose of each plan is to promote the retirement security of the employees of the employer. Financial incentives are offered to induce employers to sponsor such tax-qualified plans. All contributions into the plan reduce taxable income – employer contributions to the plan reduce the taxable income to the employer, and the same is true for the employee.[1] The investments within the plan grow tax free.[2] Reasonable expenses related to the ongoing administration of the plan can be paid with plan assets.[3] The plan assets are held in a trust and are not attachable by creditors of either the employer or the participants.[4]

Employers use these plans as recruiting and retention tools when they provide robust contributions and generous terms. Sophisticated employees see the value in such plans and the employers are able to provide these benefits in a tax advantaged environment. In exchange for these benefits, the plan must comply with the mandates of ERISA and the Internal Revenue Code. Those mandates are many but the ones that concern this audience relate to the fact that there must be a person in charge of ensuring that the plan *operates for the exclusive benefit of the plan participants.*[5] The Department of Labor (DOL) is the agency that enforces those mandates. In this capacity the DOL can 'disqualify' a plan (i.e. eliminate the tax-advantage status of the plan which would have disastrous financial consequences for the participants and the employer) or it can expose fiduciaries (those persons in charge of the plan) to personal financial liability or even criminal sanctions.[6]

The Question of Jurisdiction

Trustees naturally feel entitled to assurances that they are under the jurisdiction of the bankruptcy court where they can avoid exposure to personal liability stemming from the conduct of the debtor. It does not appear reasonable that a trustee should be subject to the jurisdiction of an unfamiliar court as a result of performing a mandated function described in the Bankruptcy Code. However, the text of section 704(a)(11) of the Bankruptcy Code appears to do just that, by requiring the bankruptcy trustee to assume the duties of the ERISA-governed plan fiduciary under the jurisdiction of the DOL.

How Bankruptcy Code Section 704(a)(11) makes a Chapter 7 trustee an ERISA Plan Fiduciary

Bankruptcy Code section 704(a)(11) effectively transforms the trustee into a plan fiduciary by requiring him to perform the duties of a plan administrator who is, by definition, a fiduciary.

> **The trustee shall** if, at the time of the commencement of the case, the debtor (or any entity designated by the debtor) served as the administrator (as defined in section 3 of the Employee Retirement Income Security Act of 1974) of an employee benefit plan, **continue to perform the obligations required of the administrator**;

Section 3(16)(A) of ERISA , 29 USC §1002(16)(A), the term "administrator" means—

> - (i) **the person specifically so designated by the terms of the instrument under which the plan is operated;**
>
> - (ii) if an administrator is not so designated, the plan sponsor; or
>
> - (iii) in the case of a plan for which an administrator is not designated and a plan sponsor cannot be identified, such other person as the Secretary may by regulation prescribe.

The administrator is a fiduciary as defined in ERISA Section 3(21)(A), 29 USC §1002(21)(A).

> (21)(A) Except as otherwise provided in subparagraph (B), **a person is a fiduciary with respect to a plan to the extent** (i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets, (ii) he renders investment advice for a fee

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or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or **(iii) he has any discretionary authority or discretionary responsibility in the administration of such plan.** Such term includes any person designated under section 405(c)(1)(B).

The following decisions illustrate the complex jurisdictional issues:

Mid-States Express, Inc.

In re Mid-States Express, Inc., 2010 WL 2653376(Bankr. ND IL 2010), illustrates the transformation of the trustee into a fiduciary in a straightforward manner. Here, the trustee, in an effort to address the obligations to the retirement plan pursuant to Bankruptcy Code 704(a)(11) asked the Court for a motion authorizing him to, among other things, distribute the plan benefits to the remaining participants and pay the related administrative expenses from the plan assets.

The Department of Labor objected asserting that the bankruptcy court lacked subject matter jurisdiction to address ERISA matters. Moreover, the DOL asserted that the relief requested by the Trustee violated the both the Bankruptcy Code and ERISA.

Even though Section 704(a)(11) imposed non-estate responsibilities upon the bankruptcy trustee, the bankruptcy court concluded that it did not have jurisdiction to address the bankruptcy trustee's actions when acting as plan administrator distributing non-estate assets to non-creditors of the bankruptcy estate.

Bankruptcy Code section 704(a)(11) did not invoke a right created by the bankruptcy code. Rather, it is a stand-alone provision which simply places the bankruptcy trustee in the role of an ERISA plan administrator. The Bankruptcy Code itself does not alter or even address these rights or obligations.

Judge Black addressed the bankruptcy trustee's position that the ERISA related motions "arise in" a bankruptcy case and therefore fall within bankruptcy jurisdiction. Nevertheless, anticipating the Supreme Court's decision in *Stern v. Marshall, Stern v. Marshall* 564 U.S. ___, 131 Sup. Ct. 2594 (2011), the court denied the motion, holding that the trustee's position would expand bankruptcy jurisdiction beyond constitutional limits. Since the bankruptcy trustee asked the court to adjudicate non-bankruptcy rights governed by ERISA and ERISA regulations, the bankruptcy court held that it did not have jurisdiction to address the bankruptcy trustee's requested relief. Instead, it agreed with the assertion of the Department of Labor that, in his capacity as ERISA plan administrator, the trustee is a fiduciary within the meaning of ERISA whose authority to terminate the plan is not governed by the Bankruptcy Code nor influenced by the bankruptcy court.

In re The Robert Plan Corporation

The bankruptcy court in *In re The Robert Plan Corporation,* (8-08-74573-reg, Bankr. ED NY Oct. 26, 2010) disagreed diametrically with the court in Mid-States. Here, the bankruptcy trustee asked for authority to act as plan trustee, pay expenses, pay professionals and take other actions to comply with ERISA. The Department of Labor objected. While conceding that the Trustee is required to act as Plan Administrator, it objected to the bankruptcy court's assertion of any subject matter jurisdiction with respect to ERISA matters.

The bankruptcy court reviewed the history of the Bankruptcy Code as well as the adoption of Bankruptcy Code section 704((a)(11) imposing ERISA plan administrator duties upon the trustee. The court held that it did have subject matter jurisdiction over such matters because it was the Bankruptcy Code, not ERISA which required the trustee to perform Plan Administrator duties. It rejected Judge Black's analysis in *Mid-States Express* as well as that of *A B & C Group, Inc.,* 411 B.R. 284 (Bankr. N.D. WV 2009). Holding that the bankruptcy trustee's duties as a Plan Administrator to an ERISA plan were fundamental to his duties as a bankruptcy trustee, the court held that it had subject matter jurisdiction over the matters raised by the bankruptcy trustee for consideration.

NSCO – Court denies trustee's request for Discharge of ERISA obligations.

In *In re NSCO, Inc,* 427 BR 165, (Bankr. D. MA 2010), the trustee, seeking to terminate the retirement plan, drafted a Termination Motion which, among other things, requested an order from the Bankruptcy Court declaring that he had fully complied with his obligations under 704(a)(11) and discharging him from any past or future liability related to the 401(k) Plan. The trustee served a copy of the Termination Motion on the plan participants and the DOL. The DOL did not contest the Court's jurisdiction to authorize the trustee to terminate the plan.

Rather the DOL asserted that, as related to the plan, the trustee is an ERISA-plan fiduciary and thus the Bankruptcy Court did not have the subject matter jurisdiction to determine whether those fiduciary duties had been fulfilled or to release him from liability for any such breaches. The Court declared that it did indeed have the authority to release the trustee from liability but conceded that it did not have the authority to shorten the ERISA statute of limitations. (The practical result of this declaration is that the trustee obtains negligible relief from the bankruptcy court as it relates to his duties under 704(a)(11) because, despite the release, the DOL reserves the right to prosecute fiduciary breaches for six years.[7])

The basis of the trustee's request was that the trustee was entitled to "derived judicial immunity" absent a case or controversy. It is appropriate for a trustee to become immune from liability by asking the court for instructions. When the trustee acts in furtherance of instructions, he has the benefit of derived judicial immunity so long as there has been full and frank disclosure to the creditors and the courts. *Mosser v. Darrow,* 341 US. 267 (1951).

In the view of the author, other than seizing the opportunity to raise the jurisdictional question, the trustee in *NSCO* had nothing to gain by presenting the Termination Motion to the DOL. He correctly obtained Court authorization to employ a competent law firm as special counsel to assist with the termination of the plan. Presumably the purpose of that employment is to determine whether the plan was in compliance from the time of his appointment through the date that all plan assets were properly distributed to the beneficiaries and the Final Form 5500 filed. Once that determination is affirmed, there is no reason to contact the DOL. All that is left to do is to document the plan data collected and the procedures employed to wind down the plan. There is little chance that the DOL will inquire about the plan and if they do, they can be provided with a copy of that documentation. While it certainly lacks the clarity of a judicial immunity order, it's the best available option for the trustee.

Practical Considerations – Trustee, protect yourself!

What are the consequences of a trustee's inability to receive the ordinary judicial discharge or even authority or instruction with respect to obligations as an ERISA plan administrator? Is the trustee left open to arbitrary liability for six years? What can the trustee do to get as near as possible to derived judicial immunity? The answer resides in studying the methods by which a traditional ERISA fiduciary would terminate a plan. ERISA professionals routinely live with the reality that the DOL is free to open an investigation into a plan whenever they receive information that warrants it. Yet it is extremely rare for them to be the subject of an unexpected investigation from the DOL. An ERISA professional can terminate a plan in such a way that he or she can be virtually certain that no information will subsequently surface that would cause the DOL to take an interest in the plan. As an additional precaution a well-documented description of the wind-down of the plan is prepared in the unlikely event that the DOL does call. The conservative course of action for a trustee is to mimic these procedures.

In the author's view, while Bankruptcy Code section704(a)(11) transforms the trustee into an ERISA fiduciary, the trustee is in a slightly better position because he is a **successor fiduciary** by virtue of the fact that he or she had nothing to do with the plan prior to his appointment. The term successor fiduciary is defined in ERISA Section 409(b). DOL Advisory Opinion 76-95 states in part:

> Section 409(b) of the Act provides that no fiduciary shall be liable with respect to a breach of fiduciary duty under Title I of the Act, if such breach was committed before he became a fiduciary or after he ceased to be a fiduciary.

A trustee (the successor fiduciary) must take the following actions to terminate the plan and comply with 704(a)(11).

- Assess the current state of the plan.
- Devise a strategy for closing out the plan.
- Follow through with that strategy until the plan termination is complete (plan assets are zero and the Final Form 5500 has been filed).

Assessment

The first step is to assess the current state of the plan. Among other things, the following need to be verified:

- All plan assets are accounted for and have been timely transferred to the trust.
- There have been no prohibited transactions between the various named parties and the plan.
- The plan document is current and has been followed.
- The service providers to the plan are still contractually obligated.

This will require communications between the asset custodian and other plan service providers.

Strategy

The second step is to devise a strategy to close out the plan. (Closing out the plan requires that the plan be in continuous compliance with ERISA and the IRC during the entire process in which all plan assets are distributed to participants.) Two primary factors affecting this strategy are the answers gleaned from the plan assessment in step one and the temper of the current plan service providers. The degree of difficulty in executing the strategy might be low, medium or high.

Low Difficulty

The degree of difficulty is low when the service providers:

- were made aware of the situation early;
- are sophisticated and have terminated many plans before; and
- are ethical business people who want to fulfill their obligations and comply with the law.

In normal circumstances, service providers can best wind down the plan and need access to the trustee to obtain signatures and little else. These service providers will provide the trustee with their contact information and a list of tasks and a timeline.

Medium Difficulty

The degree of difficulty is medium when the service providers:

- are not cognizant of the employer's financial situation;
- are not experienced at terminating plans; or
- have not been receiving timely data from the employer.

In such cases, service providers will likely not be able to terminate the plan without significant oversight. There may also be plan failures that require correction.

High Difficulty

Maximum difficulty occurs when any one of the following situations is present:

- The employer uses plan assets to pay employer expenses like payroll and rent;
- The employer stops paying the plan service providers and providing them with necessary data; or
- The service providers have stopped working on the employer's plan because they haven't been paid.

Here, it is possible that the plan participants have been defrauded and various parties charged with taking care of the plan have acted illegally. In my view, the trustee either avoids liability altogether or else minimizes it by becoming aware of these issues and addressing them immediately upon being appointed trustee. To address these issues, discuss your findings and strategy for terminating the plan with the Department of Labor.

Once the degree of difficulty has been established, the trustee can make a reasonable estimate of the time and effort required to terminate the plan.

Follow Through to Completion

Finally, the trustee must monitor the plan termination until the plan assets are zero and a final form 5500 has been filed. The plan termination process may take only a few months or else more than a year depending on several factors. (The primary factor delaying the termination is a poor strategy implemented by the trustee; another relates to difficulties in locating and obtaining distribution elections from each participant.) With the proper strategy, the plan is terminated expeditiously with few problems.

Issues Related to Paying for Services with Plan Assets

In the author's experience, plan assets are routinely used to pay the administrative expenses related to terminating the plan (provided, of course, that the plan document permits this practice).[8] When those assets are used properly, the service providers (including the trustee) get paid, the participants fairly share the expense burden, and the plan is terminated in an expeditious and orderly manner with minimal burden on the estate.

Fees for the reasonable expenses related to plan operation can be paid from plan assets.[9] Federal legislation permits this to encourage employers to sponsor retirement plans. Because the plan sponsored by an employer involved in a Chapter 7 proceeding must be terminated as an operation of law, related expenses (paying the service providers, providing the participants with their distribution elections, employing professionals, cutting checks, paying the trustee for his or her time, etc.) may be paid for with plan assets. Arguments to the contrary that involve the term 'settlor expenses' are generally incorrect.[10]

The DOL rightly demands that expenses paid for with plan assets be reasonable in light of the services provided to the plan.[11] The purpose of this requirement is to prevent the assets from being looted by those with access. Exactly what the DOL considers reasonable compensation is hard to pin down. [12] The fiduciary is required to make informed decisions related to compensation for services and, in my view, the compensation that others would charge to perform similar services is a good guide.

Election to Involve the DOL

Because the DOL can investigate so few of the ERISA-governed plans in existence, it is normally not difficult to terminate a plan without involving them. The trustee who determines that the plan is in good order and has a reasonable game plan for winding it down will save time and money by electing not to involve the DOL. The trustee in the NSCO case initiated contact with them in an attempt to obtain indemnity from liability as it relates to the plan.

A traditional ERISA fiduciary may elect to seek a determination from the IRS that the plan was qualified at the time of termination by filing IRS Form 5310.[13] (This is often referred to as a "formal plan termination".) The theory is that filing the form puts the IRS on notice that a plan is terminating and can be used as insulation from liability should they investigate at some later date. In fact, obtaining the determination letter simply means the IRS is of the opinion that the plan and trust were qualified at the time of the termination.[14] It will not shield the trustee from investigationby the DOL or insulate the trustee against liability for a fiduciary breach. Many ERISA-professionals discourage the blanket applications for determination and instead only recommend them if there is a particular issue that the fiduciary hopes to resolve. In my view the trustee who seeking to address potential investigation by the DOL is better served by simply calling them to discuss the pertinent issue as well as the benefits and limitations of submitting the Form before spending the resources required to prepare it.

Communicating with the Department of Labor

The trustee who communicates with the DOL should understand that the Department of Labor believes that it has jurisdiction over both the plan and the trustee. Nevertheless, the DOL is aware of the unfamiliar position imposed upon the trustee by Bankruptcy Code section 704(a)(11) Some regional offices have special procedures when dealing with bankruptcy trustees in an effort to accommodate this strange environment. They want to be part of the solution. The trustee who has questions about what his or her obligations as a successor fiduciary has little cause to be fearful about calling the DOL directly and seeking answers. It is the author's understanding that so long as the trustee has not intentionally furthered a fiduciary breach, the Department of Labor's policy is to assist the trustee in resolving any issues related to the plan about which the inquiry was made.

Moving Forward

The fact that Bankruptcy Code section 704(a)(11) is clumsy legislation and difficult to work with should not be taken as evidence that its repeal or modification is imminent. Several alternatives to the current situation have been discussed. One is an expansion of the abandoned plan program which relates closely to that portion of the NABT White Paper Proposal that proposes amending the language so that the plan will be considered abandoned as of the bankruptcy commencement date. This suggestion is reasonable and if adopted would relieve trustees of their current obligations to plan participants.

However, if the speed with which prior legislation has been implemented is any guide, trustees will be obligated to wind down many hundreds of plans before any of these proposals become law.

Conclusion

When a company liquidates in bankruptcy, retirement plan participants are particularly vulnerable to losing access to their retirement benefits or being charged unreasonable fees. The Department of Labor simply does not have the resources to respond to the many thousands of participants whose assets are held in those plans. Bankruptcy Code section 704(a)(11) seeks to solve this problem with a mere fifty four words! Appointing the trustee as the replacement fiduciary for the plan provides the participants with an individual required to act on their behalf with the skill of a prudent professional which in turn reduces the burden on the DOL in a material way.

In turn the trustees' duties are expanded to include the distribution of non-estate assets under the jurisdiction of the DOL. Further, while the debtor still gets a "fresh start" from the court, the trustee is deprived from receiving a similar order that the case has been "fully administered" and his liability discharged.

Although the trustee cannot be discharged from liability related to the retirement plan in the fast manner provided by the bankruptcy court, with the proper procedures, he can be virtually certain of avoiding liability for issues beyond his control. He begins his relationship with the retirement plan as the successor fiduciary who is not liable for the actions of prior fiduciaries. If he winds down the plan with the skill of a prudent professional he is free to have many of the related costs paid for with plan assets. Further, any issues that might cause the DOL to investigate the plan at some later date can be discovered and resolved by the trustee during the wind-down of the plan.

Footnotes:

1 26 U.S.C. §§ 404(a)(1)(A), 501(a), 401(a), 401(k)

2 26 U.S.C. § 501(a)

3 DOL Advisory Opinion Letter 97-03A

4 26 U.S.C. § 401(a)(13), 29 U.S.C. §1056(d) (1), and the Bankruptcy Code all address the protection of qualified plan assets from creditors.

5 29 U.S.C. §§ 1102(a), 1104(a)

6 26 U.S.C. § 7476, 29 U.S.C. §§ 1102(a), 1131

7 29 U.S.C. § 1113

8 29 U.S.C. § 1104 (a)(1) (D)

9 DOL Advisory Opinion Letter 97-03A

10 DOL Advisory Opinion Letter 97-03A

11 Letter from the Department dated July 28, 1998 to Gary E. Henderson – RE: MULTIEMPLOYER FIDUCIARY PROVISIONS UNDER ERISA

12 C.F.R. Sec. 2550.408c-2 (b)(1) General rule. Generally, whether compensation is ``reasonable" under sections 408 (b)(2) and (c)(2) of the Act depends on the particular facts and circumstances of each case.

13 Form 5310 Instructions: Use Form 5310 to request an IRS determination as to the qualified status (under section 401(a) or 403(a)) of a pension, profit-sharing, or other deferred compensation plan upon termination.

14 Rev. Proc. 2009-6