

HOW THE CASE STUDY PORTION OF WORKSHOP 21 WILL WORK

Approximately half of the workshop will be devoted to the two attached case studies. To make the session work, we need three things from you:

1. **Read through the case studies** before the workshop begins and be familiar with the facts. Also, consider the questions at the end of each case study and be prepared to share your thoughts.
2. **Bring a copy of the case studies** to the workshop. Hard copies will not be available at the workshop location. Also bring your notes.
3. Since the workshop is intended to be interactive, please **participate in the discussions**. We will have one or more stationary microphones and a facilitator circulating with another microphone to assist you.

Chuck Lax

Bruce Ashton

FIDUCIARY CASE STUDIES

WHERE'S THE MONEY?

Case Study No. 1

Best Controls, Inc. ("BCI") is a parts supplier to the automobile industry. Best maintains a traditional 401(k) plan. The sole stockholder of BCI is Walter Best ("Best"). The board of directors of BCI is comprised of Best; his son, Harry, who earned an MBA degree in finance and works in New York; and Best's wife, Mary. Best is hopeful that Harry will "come home someday" to run the company. Harry receives monthly statements about the business and for the 401(k) plan but is not involved with the operation of the business or the plan. Mary has little to do with BCI at this point, although 30 years earlier, she helped Best establish BCI.

The 401(k) plan document provides that the board of directors selects the plan trustee and an administrative committee to run the plan. When the plan was first adopted, Best appointed himself as the trustee and still serves in that capacity. Best also established an administrative committee comprised of Best, son Harry and employee Jim Green ("Green"). Best selected Green to serve on the administrative committee because of his long tenure as an employee and the fact that he was well respected by the other employees. The administrative committee has met from time to time and receives reports from the plan's financial advisor, Ben Black, on the mutual funds offered by the plan, plan expenses, and "other useful information" that Black determines. Black is a registered investment adviser and registered rep with a local broker-dealer, who helped construct the portfolio of mutual funds made available to participants. Black receives 12b-1 fees on the mutual funds.

One day, Suzie Taylor ("Taylor"), BCI's controller, approaches Green and says she "doesn't know who to talk with, other than him, since he is the employees' representative on the administrative committee." Taylor tells Green the following:

1. The company is struggling financially and losing money at a rapid rate.
2. For the last 5 months, 401(k) deferrals have not been remitted to the plan. While Taylor has prepared checks to remit the funds, Best has refused to sign them. Even though she has signature authority over BCI's checking account, Taylor reasons she had better not remit the funds without Best's approval.
3. Best recently responded to Plan participants that the Plan's TPA, Arnold Nash, had a "computer problem" when questioned as to why their last quarterly benefits statement failed to include participant deferrals. While Nash was aware of what Best said, he took no action to clarify or correct Best's misstatements or to correct the benefit statements given to the employees.

4. Taylor tried to discuss the problem with Best, but he refused, indicating it wasn't "any of her business," and assured her BCI would get "caught up" shortly.
5. As recently as yesterday, during a heated negotiation with one of BCI's critical vendors, Acme Supply Company, Best informed them that the only source of funds available to pay them at this time was employee 401(k) deferrals that had not yet been paid over to the plan. Ron Jordan, the owner of Acme, responded to Best, "He didn't care what the source of the funds was, since it is Best's problem," and that they will "cut him off" if they weren't paid in the next two days. Since Best had no other alternative to keeping the doors open, the deferrals were used to pay Acme.

Green is unsure what to do. He believes that if he raises the issue with Best, he will get the same answer that Taylor got. Furthermore, if Green raises the issue at the next administrative committee meeting, he believes that Harry will side with Best, and Green will be out voted on any attempt to remove the trustee and/or pursue collection of amounts owed to the plan. He's also concerned he might lose his job.

Green confers with his personal attorney, Ken Justice, and explains the problem. While Justice readily admits he doesn't have a lot of experience dealing with retirement plan matters, he agrees to help Green deal with this problem. A day later, Green receives an email from Justice, who tells him to resign his position on the administrative committee and stop deferring from his pay until the problem gets straightened out. Green follows Justice's advice immediately, comforted by Justice's "opinion."

Taylor next confers with Ben Black, the plan financial advisor. Black is aware that Best has stopped remitting funds to the plan, because of the monthly reports he receives. Black explains to Taylor that he has also discussed the failure to remit with Best and even advised him that he may have "criminal exposure" if prosecuted by the Department of Labor. Unfortunately, Black received no better answer than "It's my problem, not yours." Black considered resigning, but concluded he would not "rock the boat" since he did not want to give up the 12b-1 fees he is receiving.

Who are the fiduciaries of this plan?

1. Walter Best?
2. Son, Harry Best?
3. Wife, Mary Best?
4. Committee member, Jim Green?
5. Comptroller, Suzie Taylor?
6. TPA, Arnold Nash?
7. BCI supplier Acme Supply Company/Ron Jordan?
8. Financial advisor, Ben Black?
9. Green's attorney, Ken Justice?

What fiduciary breach(es) may have occurred, and who may have liability for the breach(es)?

Are there any prohibited transactions? By whom?

What could/should have been done to protect the participants? The non-breaching fiduciary(ies)?

WHY IS IT ALWAYS THE DOCTORS?

Case Study No. 2

Associated Medical Services, P.C. ("PC") is a multi-specialty medical practice. The PC is comprised of 15 voting (equity) shareholders, 35 non-voting (non-equity) shareholders, 20 staff physicians and 75 other staff members. The voting shareholders also serve as the Board of Directors of the PC.

The PC has maintained a traditional profit sharing plan since 1990. Plan assets have grown to more than \$20 million. The founders of the practice, John Smith, Bob Jones and Jim Clark, have served as the plan's trustees since its inception. The plan document gives the Board of Directors the authority to elect and remove trustees, and the Board has annually "ratified" their continuation each year. The plan's administrative expenses are borne by the plan itself.

The trustees of the plan generally meet once a year (in December) with the plan's CPA, Roger White; the plan's TPA, Ken Harris; and its stockbroker, Andy Bock. Note that the PC retains a separate firm for its own accounting and tax matters. Also note that White is Dr. Smith's cousin and personal accountant.

At the December 2015 board of trustees meeting, the following occurs:

1. Smith and Jones inform the others in attendance that Clark will not be attending the meeting because he recently left for Florida for the winter; but as long as they both are in agreement on issues; Clark's vote will not be required.
2. CPA White informs the group that the audit fees for the 2015 plan year will be increased by 50% over the 2014 audit fees. When asked why the fees are increasing so significantly, White responds that there had been no increase for the past 5 years and the fees were increasing merely to "keep them in line with fees charged by other accounting firms doing similar work." Smith and Jones approve the increase; Smith commenting that White has "always been fair with them."
3. Next, stockbroker Bock reports that with regard to the plan's investments he "oversees," the plan has had its third consecutive "terrific" year. He points out

that the plan's assets are up more than 15% for the year, compared to a 12% increase in the S & P 500 Index. This occurred in spite of having lost hundreds of thousands of dollars on an investment in a technology company that recently filed for bankruptcy. Bock attributes this success to his creating a portfolio of investments almost exclusively comprised of health and technology related companies that continue to outperform other industry segments. Smith and Jones congratulate Bock and note that they are "counting on him to continue his good work."

4. Smith reports that CPA White recently introduced him to a client who is a real estate developer putting a deal together. Smith says he agreed to take an equity position in the deal, but an additional \$500,000 was needed. The developer offered the plan an opportunity to "loan the money to the deal," which would provide a safe return of 3.5% per annum over the 10 year term of the loan. The loan would be secured by a second position in the real estate (behind the primary lender) and the personal guarantee of the developer himself. Smith notes that the 3.5% return generally exceeds the return available on fixed income obligations. Since the funds were needed quickly, after a brief discussion with Jones, Smith authorized Bock to liquidate sufficient plan assets to make the investment, and the loan was made.
5. Smith then asks TPA Harris to discuss a restatement of their plan that he has prepared. Harris reports that almost all qualified retirement plans need to be restated to comply with legislation named the Pension Protection Act of 2006 ("PPA") and other IRS guidance. When asked to discuss any substantive changes, Harris indicates that most of the changes "would not affect them" but were "required by law". Harris adds that since he was restating their plan document, he had incorporated a couple of modifications that he believes will "facilitate the operation of the plan for the PC."

Harris indicates he has changed the allocation methodology so that the voting shareholders could increase their allocations substantially and if they chose, they could reduce the allocations for the non-voting shareholders or the staff physicians. While sounding discriminatory, he assures them that through a technique known as "cross-testing" the plan will continue to maintain its tax qualified status. Harris next indicates that he has eliminated the plan's loan provisions because of the complaints he received from the PC's practice administrator, Beth Campbell, due to "all the additional work it made for her" and because many of the loans were being used for "non-essential purposes." While Smith comments that with regard to plan loans "it really was the employees' money," Smith and Jones conclude that they trust Harris to do what "is best for the plan." The restatement is signed.

Who are the fiduciaries of this plan?

1. Dr. John Smith?
2. Dr. Bob Jones?
3. Dr. Jim Clark?
4. The Board of Directors of the PC?
5. Roger White, CPA?
6. Ken Harris, TPA?
7. Andy Bock, stock broker?
8. Beth Campbell, practice administrator?

What fiduciary breach(es) may have occurred, and who may have liability for the breach(es)?

What could/should have been done to protect the participants? The breaching fiduciary(ies)?
Any non-breaching fiduciaries?