As A 401(k) Sponsor, A Class Action Lawsuit Is The Least Of Your Legal Worries

By Ary Rosenbaum, Esq.

Having been in my own practice for over 6 years, it's a broken record hearing from 401(k) plan sponsors on how they have nothing to fear about being sued since their plans are small potatoes. The problem with that view is that a big class action lawsuit is the least of your worries as a plan sponsor. This is why you need to be vigilant and diligent in your duties as a retirement plan sponsor. So this article is about the many threats that could hurt you in the pocketbook when it comes to your 401(k) plan.

No class action lawsuits for small and medium sized plans… for now

When I talk about fiduciary responsibility and the need to review the plan on an annual basis, I'll usually hear it from a 401(k) sponsor that everything is fine with their plan even though they really have no idea. In addition, they'll tell me that their small plan isn't going to be targeted for a class action lawsuit because they're small potatoes for ERISA litigators. Yes, it's true that larger plans are the target for the ERISA litigators who want to get a nice fee from a multi-million settlement and that's going to be impossible to get from a 401(k) plan with $1-10 million in plan assets. Settlements for plan participants who sue their former employer for a breach of fiduciary duty of running the 401(k) plan have varied from millions to over $100 million and the fact is that most employers who sponsor a small or medium sized plan aren't going to fork over that kind of settlement because they don't have that kind of money and there isn't enough damage to plan participants to justify that type of settlement. An employer isn't going to fork over $5 million in damages if the plan only has $5 million in assets. While ERISA litigators aren't targeting small to medium sized employers, eventually they will have no choice but to start targeting smaller plans. Why? Eventually, they're going to run out of larger plans to sue. The fact is that every day, plan sponsors are being more vigilant over fees in their plan because of all these class action lawsuits as well as the requirements for plan sponsors to get fee disclosures and make sure participants receive them as well. So if larger plans are going to be better run in terms of expenses, eventually ERISA litigators will target smaller and medium sized plans. There have already been a couple of class action lawsuits against smaller plans because of issues concerning fees as well as an improper investment made by the plan sponsor in a trustee directed investment 401(k) plan. While most 401(k) plan sponsors have a better chance of getting struck by lightning than getting sued, that's the least of your problems as a 401(k) plan sponsor.

The lawsuit by an angry former employee

I worked for a company once where I thought they were cheap when it came to raises, and their favorite employees were kind of incompetent. That being said, I never thought they were the type of people who would discriminate against anyone because of gender, race, religion, or sexual preference. There was an employee who was caught in a lie about work hours and he was fired for cause. That didn't stop him from threatening to sue my employer for discrimination. Even before a lawsuit could be filed, my bosses forked over $4,000 as nuisance value. Angry former employees are the group likeliest to complain about your 401(k) plan and the likeliest to threaten a lawsuit against you. While these nuisance 401(k) lawsuits haven't been something that has been popping up, why would you let your 401(k) plan possibly be used as a weapon for an aggrieved former employee? That's why it's a good idea to get your plan reviewed for any expense and compliance issues that could give ammunition to a current or former employee to consider targeting you for litigation.

(IRS)

An audit by the Internal Revenue Service

All qualified plans such as your 401(k) plan are considered qualified plans because the intent is to comply with Section 401 of the Internal Revenue Code to get tax deferred treatment of the assets in the plan.

Qualifying with the Internal Revenue Code means complying with it. So any issues with your 401(k) plan could threaten that qualification. Those problems could result in penalties or in some extreme measures, plan disqualification where your formerly deducted employer contributions are disallowed and participants would have their retirement benefits immediately taxable. Before we get to the penalty phase, you have to understand that all qualified plans that file a Form 5500 because they're required to run the risk that an IRS agent can audit them. The reasons for the audit can be due to an issue on Form 5500, a complaint made to the IRS, or usually, just a random audit to ensure voluntary compliance with the Internal Revenue Code. The audit usually involves the review of a specific year. The auditor will look at the plan document, plan valuation, and employee census for any possible compliance problems. A plan that's in good compliance will get a no change letter from the auditor. Some plans may have minor issues that can be corrected with a penalty. Larger errors such as compliance testing issues or failure to have a plan document that was timely restated could lead to thousands of dollars in penalties. Plans that have minimal compliance with the Internal Revenue Code could risk plan disqualification.

An audit by the Department of Labor (DOL)

While the IRS is concerned with tax qualification, the DOL is concerned with the rights of plan participants. Like with the IRS, the DOL could target a plan that has issues with their Form 5500, a complaint by an aggrieved plan participant, or a random audit. The DOL does a thorough review of Form 5500 especially when the plan's return states that they don't have the required ERISA bond and/or whether participant deferrals were deposited late. One thing that the DOL differs with the IRS is that they are more concerned with the rights of current and former plan participants. So they are going to be thorough, especially when a current or former participant lodges a complaint. I've been in situations where the DOL demanded that a certain former participant receive a retirement benefit under a pension plan even though it was the intent and an agreement with that participant to exclude them. Thanks to fee disclosure regulations and the concerns about the fiduciary process of 401(k) plans, the DOL is interested in conducting more plan audits. The DOL auditors are trying hard to make sure that plan sponsors determine whether their fees are reasonable as well as making sure they conduct a prudent process of selecting and replacing plan investments. The DOL process can be far costlier than any lawsuit or IRS audit. 67% of DOL investigations into employee benefit plans result in some type of monetary result to the plan. The penalties and restoration of benefits that a plan has to pay often averages in the tens of thousands of dollars. It's not a class action lawsuit, but it's something very painful.

Lawsuit by the DOL

If the DOL sees some egregious behavior on the part of the retirement plan sponsor that an agreement through a DOL audit can't be made or is too egregious to be considered to be made, they will sue the plan sponsor. The DOL sues over 100 employee benefit plans a year, usually dealing with plan sponsors who can't or won't fork over contributions to the plan that they're required to. Many lawsuits involve insolvent plan sponsors who ceased operations but contributions are still owed to the plan. While you may think that's not an issue for you, I'll never forget the plan sponsor who was sued for over $3 million in some claims of embezzlement that were simply untrue. As with any lawsuit, you can be sued without doing anything wrong.

THE ROSENBAUM LAW FIRM P.C.

The Rosenbaum Law Firm P.C.
734 Franklin Avenue, Suite 302
Garden City, New York 11530
(516) 594-1557

http://www.therosenbaumlawfirm.com
Follow us on Twitter @rosenbaumlaw