

Plan Expenses: Four Things About the Labor Department's Guidance We Still Don't Understand

What can be paid from the assets of an ERISA plan? What can't? This question has been addressed in sporadic guidance by the Labor Department, most recently in Advisory Opinion 2001-01. We don't pretend to discuss here the guidance in any detail. It has been thoroughly covered in these pages, for example, by Nell Hennessy and Marla Kreindler in the Summer issue (p. 75, "Drawing the Line Between Settlor and Plan Expenses").

But after reading and rereading Advisory Opinion 2001-01 and its numerous commentaries, we have a few residual questions. We set them forth here. The reader will notice we leave them as puzzles because—even after the sea of ink spilled on the topic of permitted plan expenses—we just don't get it.

First Thing We Don't Understand: What Law Are They Applying?

The legal authority for Advisory Opinion 2001-01 is so hard to locate, we thought we'd start by trying to figure it out. After looking hard, we conclude it isn't in the obvious places—like ERISA or the common law of trusts. So where could it be? After guiding the reader along our fruitless hunt through ERISA and the case law, we leave him or her with a few guesses, below.

Advisory Opinion 2001-01 purports to apply ERISA to determine what expenses can and can't be paid from the plan. Following a course set by earlier guidance, the opinion divides expenses into "settlor" functions and fiduciary or plan functions. Settlor functions include expenses for the formation and design of the plan. They are "incurred for the benefit of the employer and would involve services for which an employer could reasonably be expected to bear the cost in the normal course of its business operations." Payment of

settlor expenses from plan assets, according to the guidance, is a fiduciary breach under Section 404(a), and a prohibited "inurement" to the employer under Section 403(c).

Now, given a statute where the employer can be both creator and administrator of the ERISA plan, the settlor/fiduciary distinction is a useful ERISA concept. Developed mostly by case law, the distinction separates employer decisions that are subject to ERISA's fiduciary obligations, from those "settlor" decisions that are not. The DOL's plan asset guidance more or less tracks the courts' distinction between settlor decisions (plan design and creation) and fiduciary decisions (plan administration).

We happen to think that the robustness of the settlor/fiduciary distinction is an interesting question in itself, and hope somebody might volunteer to write about it for the *Journal*. But even ignoring this point, and accepting that ERISA draws a bright-line between settlor and fiduciary acts for Section 404 purposes—it simply does not follow that the same line applies in determining what expenses may be paid from plan assets.

In fact, the statute suggests otherwise. The statute shows that the fiduciary/settlor distinction plays *no* legitimate role in defining permissible plan expenses.

We see this specifically in the prohibited transaction exemptions under Section 408. Section 406 specifically prohibits a fiduciary from (among other things) using plan assets to pay the expenses of any of the plan's service providers. Section 408(b)(2) provides an exemption for compensation paid for the "establishment or operation" of the plan. That is, Section 408(b) expressly contemplates the use of plan assets to pay for a patently settlor expense—the costs of plan "establishment."

Of course, Section 408's express exemption does not end the inquiry. Satisfaction of Section 406(a) (via a Section 408 exemption) is not a safe harbor for ERISA compliance. The expenses must also satisfy the exclusive benefit rule of Section 404(a), as well as Section 403(c)'s requirement that plan assets not "inure" to the employer's benefit. Sections 404(a) and 403(c) raise especially tricky issues, because both allow plan assets to pay only for "administering" the plan. Neither mentions permissible expenses for plan "establishment" as does Section 408(b).

Does this mean that all expenses for plan "establishment" that pass under Sections 406 and 408, necessarily fail under Section 403(c) and 404(a), because not for plan "administration"?

No. This can't be. It would render the 408(b) exemption a nullity (an *abborendum* in statutory construction). There must be a category of expenses for plan "establishment" that don't fail Section 403(c) or 404(a).

The Labor Department perhaps anticipated this argument. Advisory Opinion 2001-01 suggests the possibility of a very narrow such category. In passing, the opinion notes that expenses for the "establishment, design and termination of plans" might be fiduciary activities in the context of multiemployer plans. Is the Department setting up an argument that the 408(b) exemption for plan "establishment" satisfies Sections 404(a) and 403(c) solely in the multiemployer plan context?

If this narrow reading is intended (the guidance is too terse for us to tell), it is not supported by the statute. Both 403(c) and 404(a) confine permitted plan expenses to the costs of "administration." If this term is intended to be different from plan "establishment" the distinction would appear to apply to multiemployer plans as well as single employer plans.

Moreover, the Department's narrow reading (if this is what it is) contradicts the whole, admittedly tension-ridden, statutory scheme. The prohibited transaction exemptions of Section 408 permit a variety of practices that violate a strict reading of Section 404(a)'s exclusive benefit rule. A much-discussed example is Section 408(c)(3), which permits the employees or agents of a "party in interest" to serve as fiduciaries. This exception is not construed to apply, for example, only to the employee/administrators of multiemployer plans. It is also understood to allow an employer's own employees to serve as plan administrators and trustees. This is "an unorthodox departure from the common law rule against dual loyalties" and in literal violation of a traditional common law reading of Section 404(a)'s exclusive benefit rule. (*Donovan v. Bierwirth*, 538 F.Supp. 463, 468 (E.D.N.Y. 1981), affirmed, as modified, 680 F.2d 263 (2d Cir. 1982).)

That is, the Department rightly sees Section 404(a) as an overriding obligation that must be met independently of the prohibited transaction rules of Sections 406 and 408. But the statute falls apart unless we read satisfaction of Section 406 as satisfaction of Section 404(a), absent some factor in addition to the bare elements that placed the transaction within the four corners of Sections 406 and 408. Without this implied override, the employer's administration of its own trusts runs headlong into Section 404, and the statute departs from Congress's stated purpose in its enactment.

We would also note that in enacting MPPAA, Congress again permitted trust assets to pay for the "establishment or operation" of an ERISA trust, under ERISA Section 4223 (dealing with "withdrawal liability payment funds" established by the sponsors of multiemployer pension plans). Section 4223 requires the fiduciary of a trust created under that section to discharge his or her duties "in accordance with the standards for fiduciaries prescribed by this act." That is, in 1981 as in 1974, Congress saw no contradiction in subjecting a trustee to the fiduciary standards of Section 404(a), and also allowing him or her to use trust assets for the "establishment" of the trust.

And another point. In the ESOP provisions of former section 409 of the Code, Subsection 409(i) expressly permitted the employer to use plan assets for the "establishment" of the ESOP. In contrast with certain other Section 409 provisions (Subsection 409(k), for example), the 409(i) plan expense rules did not include language stating that such actions were permitted "notwithstanding any law." We must conclude that Congress already believed that these "settlor" expenses were legal under ERISA, and that as a consequence, no language was needed to provide an ERISA override.

The very rationale employed by Advisory Opinion 2001-01 shows why its application of the settlor/fiduciary distinction to plan expenses cannot possibly satisfy ERISA's statutory scheme. Recall that the guidance defines settlor expenses as those "incurred for the benefit of the employer," which "involve services for which an employer could reasonably be expected to bear the cost in the normal course of its business operations."

But of course, *all* expenses paid from plan assets are—absent the trust—borne by the employer in the normal course of business. It is the employer's ongoing economic interest in its own benefit plans that distinguishes ERISA from the common law of trusts. It is this ongoing interest that requires us to look beyond Section 404(a) to Section 406 and 408 for guidance as to what the employer is permitted to do with respect to its own benefit plans. As we have seen, these sections permit paying the costs of plan formation from plan assets. The Department's guidance fails to find support in ERISA in its specifics because it fails in its underlying theory.

Having searched ERISA in vain for statutory authority for the position taken by Advisory Opinion 2001-01, we turn to the common law of trusts. There is a surprising paucity of authority on the payment of "settlor" expenses incurred after establishment of the trust. Some (sketchy) authority suggests that if the trust document broadly contemplates use of plan assets to pay for trust amendments, such

payments are permitted without regard to the amendment's purpose. If this is the platform for the Department's guidance, it is a narrow and rickety one indeed.

We would also note that in many instances, it is necessarily the case that trust amendments for settlor purposes will be paid from trust assets. Take, for example, the trust that is reformed under the doctrine of *cy pres*. It is virtually certain that the expenses of plan amendment—by definition necessary to effectuate the intent of the deceased settlor—will be paid from plan assets, if only because no other source is available.

All of which is to say that in this, as in many other ERISA questions, we must return to the words of the statute. The common law deals with trusts that can last over many decades, beyond the lifetime of a settlor who in any event severed his economic interest in trust assets at the time of its creation. The common law simply does not speak to many ERISA questions—including, apparently, this one. For this reason, Congress chose to modify the common law for ERISA purposes. And as we have seen, Congress spoke expressly on the legality of using plan assets for the payment of plan formation and design—and spoke affirmatively.

There is of course also the so-called federal common law of trusts contemplated by ERISA's drafters. We raise this issue only to dismiss it. Having developed the settlor/fiduciary distinction, the federal courts would appear not to have addressed its application to the question of permitted plan expenses.

In sum, we have looked for the legal foundation of Advisory Opinion 2001-01, and failed to find it in ERISA or the common law. But having promised above to suggest possible alternative sources of law, we confess we are stumped.

***Second Thing We Don't Understand:
Does the Guidance Make Any Sense at All?***

Enough about its legality. We also wonder whether the settlor/fiduciary distinction as applied to plan expenses hangs together as a logical matter.

Let's take a look at how the guidance is applied. According to the Department, settlor expenses for the formation and design of the plan are not permitted plan expenses. But according to Advisory Opinion 2001-01, permitted fiduciary expenses include the costs of amendments to implement a fiduciary decision, amendments to comply with the law, and employee communication about recent amendments.

An Appendix to Advisory Opinion 2001-01 sets forth examples to illustrate these distinctions. We pick a few of these to illustrate our own point.

Take for example, the plan spinoff of Hypothetical 1. Impermissible "settlor" expenses include the costs of amending the plan for the spinoff. Permitted fiduciary expenses include calculating the amount of transferred assets.

Or consider the loan program of Hypothetical 3. Impermissible settlor expenses include creating and designing the loan program (including drafting the plan amendment and other loan documents). Permitted fiduciary expenses include the costs of administering the loan program once in place.

In explaining why the loan and spinoff amendments are both settlor in nature, the guidance explains that the fiduciary has "no implementation obligations under the Plan" until the plan is actually amended.

A third example is the act of amending the plan to comply with the law. Permitted fiduciary expenses include the costs of amendments necessary to maintain the plan's tax qualified status, and to comply with ERISA and other federal law. Impermissible settlor expenses include payments for fees to analyze the employer's various options for compliance with new laws.

Are any of these distinctions remotely comprehensible even as a theoretical matter?

Consider the Department's distinction between settlor and fiduciary amendments. At the most general level of analysis, we observe that all plan drafting—for whatever kind of amendment—is for compliance with the law. This is because ERISA requires that the plan be in writing.

Moreover, all plan drafting is for the purpose of employee communications. By law, the plan document *is* an "employee communication." The very purpose of requiring a plan document, according to ERISA legislative history, is so that employees would be able to know their rights merely by looking at the plan. To this end, ERISA requires that participants be allowed to view the plan document on demand, and penalizes the administrator who refuses to supply the document when requested. A good deal of drafting time is devoted to ensuring the plan communicates clearly and unambiguously. And an abundance of federal case law shows that whatever is communicated, intentionally or not, may well be the plan.

It can be seen that, in allowing the plan to pay for the costs of complying with the law and for employee communications, Labor Department guidance virtually swallows up its own prohibition against paying the expenses of "settlor" amendments.

But what is true in the general sense is obviously and acutely apparent in the specific. Take the loan example. As anyone knows who has ever sat down to draft plan amendments, the task begins after an officer of the employer has decided to add a loan program. The settlor decision begins and ends there. Virtually all of the time spent on "developing" the program is research and drafting devoted to ensure the loan amendments comply with ERISA, the Internal Revenue Code, the Family and Medical Leave Act, the Truth in Lending Act, and so forth.

The same goes, of course, for the research and amendments necessary to effectuate the plan spinoff in Hypothetical 1. For an example of the sort of inquiry necessary to ensure a spinoff satisfies ERISA, the reader might take a glance at our article in this issue on the recent Second Circuit decision in *Flanigan v. GE*. The employer's decision to spin off plan assets is one step. Ensuring the spinoff satisfies ERISA and the plan's own promises to employees is the next step, a time-consuming but necessary one to effectuate the settlor's intent and ensuring compliance with the law.

What about the costs of developing alternative plan designs to attain a single objective? Advisory Opinion 2001-01 says these costs are settlor in nature. Again, experience tells us this cannot be so. The employer typically directs its employees and agents to change the plan to achieve a broadly stated objective (add a loan program, amend the benefit structure, modify the distribution options, add a new group of employees to the plan). The time devoted to developing alternative routes involves determining which are administratively efficient, cost-effective to the plan, nondisruptive to participants, and legal. All the work devoted to developing options is merely effectuation of a very generally stated settlor intent, and all work is done in tandem with analysis of each option's compliance with the law.

In short the work required to form, design, and modify a plan is minutely intertwined with fiduciary objectives—compliance with the law, communications to employees, administrative concerns. On inspection, the distinction between settlor and fiduciary expenses in the Department's hypotheticals dissolves to nothingness.

***Third Thing We Don't Understand:
How Could It Possibly Be Administered?***

We also question how the distinctions drawn in Advisory Opinion 2001-01 could be administered. The fundamental problem here,

of course, is that the distinctions between settlor and fiduciary expenses are seen to be largely meaningless. If its very theory makes principled compliance difficult, the same flaw must pose a challenge to principled, consistent enforcement.

Even assuming that some activities can be divided into settlor and fiduciary acts, we wonder how a practical tracking system can be devised to separate the two, or how such a system could be monitored.

For example, consider the draftsman who amends a plan for compliance with the military leave provisions of USERRA. These are fiduciary expenses, according to Advisory Opinion 2001-01. But in the course of his or her work, the draftsman reviews the entire plan and amends to ensure he or she hasn't disrupted all related provisions including those related to other types of employee leave, elective contributions, loans, and distribution paybacks. Which of these are "necessary" for compliance with the law? Which are merely good practice? Even the most conscientious drafter, acting with the best of intentions and in the best faith manner, will end up making guesses. In monitoring compliance, the Department will be stuck with second-guessing at best.

Having developed an unauthorized and untenable distinction, the Department is stuck with the job of making it work. We wonder whether it can be done other than in a haphazard manner.

***Fourth Thing We Don't Understand:
Why Did They Release the Guidance in This Form?***

We have grouched in earlier editorials about the Department's slowness in issuing authoritative guidance on significant issues. Our complaint applies here in spades.

The question of what expenses may and may not be paid from a plan is important for employers, administrators, and participants alike. The Department's own position on the question would appear to be contrary to the statute. And yet, on this important issue, where the Department would seem to need the highest level of judicial deference to overcome the obvious statutory deficiencies of its own position—no regulations. The only guidance has been in a string of opinion letters of no legal authority. For a while, in fact, the Department seemed content to have its position articulated by one of its regional offices.

We confess that this fourth question is more of a "there you go again" observation than a puzzle, so we have little to add on to our previous grumpy comments on this topic.

Conclusion

We have raised a number of puzzles about Advisory Opinion 2001-01, including the possibility that it is extra-legal, illogical, inadministrable, and inappropriate. Of course, the Department's concern in this area is long-standing and legitimate. We wonder, however, whether this most recent guidance is an overreaction to their realistic concern that participants lack adequate information about plan expenses, especially 401(k) plan expenses. In particular, given that pension plans are voluntary, we wonder why it makes sense to impose restrictions that not only are problematic in themselves, but make it more costly for employers to maintain qualified plans.

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