Are You Wearing the
Although a benefit fund trustee’s duty is always to fund participants, that duty can at times be in conflict with the trustee’s loyalty to the union or employer that appointed him or her. Trustees at the 58th Annual Employee Benefits Conference last November discussed scenarios describing this two-hat dilemma. Trustees may have a different take on the same situation.

At the 58th Annual Employee Benefits Conference in San Diego last November, the authors presented two sessions of a class entitled “Are You Wearing the Right Hat?” as part of the fiduciary responsibility track. More than 500 trustees attended these sessions. The purpose of the class was to help trustees identify and address the two-hat dilemma.

What is the two-hat dilemma? Attorney Ira Mitzner best described it in an article for the April 2007 Benefits & Compensation Digest:

An employer or union official wears the hat of a trustee when sitting on the board of a fund. His or her duty to the participants and beneficiaries is often at odds with the trustee’s loyalties to the entity (union or employer) that appointed the trustee. An understanding of this two-hat dilemma is essential to all aspects of fiduciary responsibility.

Trustees in the class could choose which of nine scenarios they wanted to discuss. Each scenario described a situation where a trustee might have one or more two-hat dilemmas. The panelists used the International Foundation’s audience response system to poll participants as to which scenario they wanted to discuss. They asked one to three additional audience response questions to further stimulate discussion of the scenario. Panelists roamed the audience with microphones to receive participant comments. In each class, a number of scenarios were covered.

Right Hat?

by | Lawrence R. Beebe, Joseph J. Burke, CEBS, Peter F. Castellarin, William A. Martin and Andrew E. Staab
This article presents five of the scenarios trustees discussed.

Scenario #1—Quid Pro Quo

The Case

Joe is the apprentice coordinator of the local union’s apprenticeship program. Bill is the employer sponsor. Both serve on the apprentice fund’s trust fund.

Joe approaches Bill and says he needs some additional sponsorships for the annual apprentice dinner so that everyone can have a good meal and upscale prizes.

Bill also serves as a management trustee on the local’s trust funds. Joe asks Bill to approach two investment managers that make investments for the fund’s portfolio. The managers have a close relationship with Bill. Joe wants Bill to ask the managers if they can increase their sponsorship to the apprentice event.

Bill feels a little uneasy but agrees to do so. He asks the investment firms for additional contributions on behalf of Joe and the apprentice funds. The investment firms make a donation to the apprenticeship fund for the additional sponsorships support.

It just so happens that at the next pension board meeting, the fund administrator reports that only two service providers have not adequately disclosed their fees, as required by the recent federal disclosure laws. The fund attorney agrees. As it happens, they are the firms that just provided additional sponsorship money to the apprentice program.

During a break Bill approaches Joe, newly appointed to the pension board, and says, “Those disclosures seem okay to me—more than adequate! What do you think, Joe?”

The Discussion

Lots of issues come to mind when reading the pattern of Scenario #1. The audience members at the 2012 Annual Conference commented on the propriety of Joe, the apprentice fund coordinator, putting pressure on Bill, an employer trustee, and two of the fund’s investment managers to increase their donations to the annual apprentice dinner. Joe’s objective is to “have a good meal and upscale prizes” at the dinner.

The audience members were sensitive to the recent focus of the U.S. Department of Labor (DOL) on apprenticeship and training funds and how they use their assets. DOL Field Assistance Bulletin 2012-01 focuses on apprentice graduation dinners and promotion. Its emphasis is not on whether graduation dinners should exist, but rather whether it is appropriate for the apprenticeship fund to pay for them.

In Scenario #1, there is no discussion of the fund paying for good meals and upscale prizes. Accordingly, there is no concern about asking a plan service provider to donate or contribute monetary support for the annual apprentice dinner.

A few audience members commented that it appeared inappropriate for the employer sponsor and the investment managers to contribute to the dinner, because it created the appearance of a prohibited transaction. However, it is not a prohibited transaction; in Scenario #1 neither the employer trustee nor the investment managers are expecting anything in return for their monetary contribution (except recognition for their support).

If the facts were changed to make the investment managers potential service providers, then there would be a prohibited transaction concern. It would be a prohibited transaction if a service provider candidate’s sponsorship was intended to guarantee its selection.

Scenario #1 takes us from the apprentice fund to the pension fund,
particularly with regard to the same investment managers’ Section 408(b)(2) disclosures. In spite of fund counsel’s conclusion that the disclosures are deficient, Bill works behind the scenes to generate support for the investment managers, and Joe is the easy target. Concerns should be stated as to what Bill has at stake with these particular investment managers, who are on two of Bill’s trust funds. Why would Bill risk breaching his fiduciary duty to protect these investment managers? Why would Joe risk breaching his fiduciary duty by unwittingly joining Bill? Will Joe have a co-fiduciary breach if he keeps quiet about Bill’s motives?

Scenario #2—
408(b)(2) Disclosures

The Case

The plan has asked all service providers to submit documentation to plan sponsors about (1) the services performed and (2) the fees and compensation for performing those services. The plan administrator has received the answers to the disclosure request and has noted that the replies can be separated into three groups:

1. Some service providers present the requested information so that the plan can easily use it.
2. A second group tells the plan exactly where to go to obtain the needed information.
3. The third group tells the plan that it has all the information it needs and provides no other details.

Some trustees believe that all service providers have provided the necessary requested information while other trustees think that some of the service providers have not gone far enough in providing the requested information. There is no clear DOL guidance on the subject.

The Discussion

Scenario #2 directly addresses the timely topic of Section 408(b)(2) disclosures. This topic sharpens the fiduciary duty to monitor pension fund service providers, and it adds a layer of responsibility for all pension fund trustees. While service providers grapple with what is expected of their disclosures, trustees grapple with the responsibility to obtain and evaluate service provider disclosures. The focus is on service providers, but it is the trustees who have the most at stake. There is little guidance on what constitutes an adequate disclosure. If a service provider fails to adequately disclose, then it would be a prohibited transaction for the plan to continue the service provider relationship. The burden is always on the trustees to avoid prohibited transactions.

Scenario #2 presents three levels of detail with regard to the plan’s service providers. One level, Group 1, provides what are perceived to be adequate Section 408(b)(2) disclosures. Group 2 provides the trustees with instructions on where to find the information that would constitute an adequate disclosure. Group 3 simply advises the trustees they have all the information they need and leaves no further details. With this continuum, the Annual Conference audience members found Group 1’s disclosures to be adequate, and they found Group 3’s disclosures to be inadequate. There was a noticeable split on Group 2, because it appears that Group 2’s “disclosures” were directly between Groups 1 and 3 on the continuum.

The panelists challenged the audience by saying there is no difference between Group 2 and Group 3, except Group 2 added a layer of courtesy by telling trustees where to find the information.

Although it may be environmentally sound for Group 2 to save paper and provide instructions, the regulations require actual disclosure. In other words, Group 2 should not be allowed to get away with not doing as Group 1 did. The appropriate advice to this plan is to accept and evalu-
ate the disclosures from Group 1 and send a nice but direct letter to Group 2 providers stating that they must provide affirmative disclosures. Group 3’s service providers deserve a stern communication advising that their nondisclosure will result in a termination of the service provider relationship unless adequate disclosure is made within a short time period.

**Scenario #3—Allocation of Expenses**

**The Case**

The pension plan owns the building it occupies. It has a mortgage on the building. There are six tenants in the building. Two are for-profit entities, one is the local union that cosponsors the pension plan and the others are the employee benefit plans associated with the pension plan. The pension plan charges a fair market rent to the two for-profit entities. The union is charged rent based on a rate negotiated between the union and the pension plan administrator. The other plans are allocated their share of expenses of the building.

An outside consultant is hired every five years to allocate the expenses of the building. In previous studies common area square footage was not used in the allocation. The current study proposes taking into account the common area square footage in the allocation. This will result in the health and welfare plan paying a much higher percentage of costs. The health and welfare trustees object stating that their plan cannot afford the increase.

Some additional facts: The welfare fund underwent a downturn over the last several years. The trustees had to change benefits and increase contributions. Prior to committing to the building, the welfare trustees toured and agreed to move into the building through resolution of the board, but no formal rental agreement exists. The rental market is down in the general area; it would be difficult to find another occupant. Currently, the welfare fund occupies 35% of the building. The building was constructed recently and has been occupied for two years. The pension fund trustees designed the building largely based on a “commitment” by the welfare fund trust.

**The Discussion**

The first question the panelists asked was whether the outside consultant should be instructed to allocate the square footage as was done in the past, ignoring the common areas. Participants were split three ways on the answer. Thirty-four percent of the audience would leave the allocation the same way it was always done; 28% wanted to follow the recommendation of the consultant; and 38% wanted more information before making a decision. Most who wanted more information wanted to know why the consultant thought that including the common area square footage was a fairer allocation method than allocation without the common area square footage. The consensus of those who voted no was that the plan hired a consultant to determine how costs should be allocated and its advice should not be ignored.

The panelists then asked the audience whether there were other issues in the scenario that the trustees needed to address. Sixty-nine percent (69%) said yes and 11% said they thought so. The issue that was most raised was that when the rent was negotiated between the union and the plan, apparently fair market rent was not addressed. One other potential problem that nobody identified was that the plan should investigate whether the rental of space to for-profit entities would result in unrelated business income tax (UBIT).

**Scenario #4—Possible Confidentiality Breach**

**The Case**

Mary Smith was an assistant administrator of the Stonecutters Local Pension Fund. She had worked for the fund for approximately five years before she got married. Her new husband worked for a nonunion stonemasonry company. His employer competed against union employers that contributed to the Stonecutters Local Pension Fund.

Mary Smith had access to confidential information about the fund—i.e., the fund’s participants and contributing employers—which could be provided to her husband and subsequently transmitted to his nonunion employer. At a board of trustees’ meeting, both management trustee and union...
trustee raised the question as to whether Mary Smith should be terminated from her position because of her new marital status.

The Discussion

The first of two questions to the audience was whether the possibility of a breach of confidentiality makes Mary Smith’s continued employment with the fund questionable. Forty three percent (43%) said yes and 57% said no. The panelists said that just the possibility of a breach of confidentiality was not enough to terminate employment. Mary should be counseled that the trustees were aware of the situation and any breach would result in her termination.

Then the audience was told that Mary Smith’s employment had been continued and that a transmittal of confidential information had occurred. The panelists asked whether a breach of fiduciary duty on the part of the trustees had occurred. The panelists received 227 responses; 114 voted “Yes” and 113 voted “No.” There was an audible gasp from the class when the vote was revealed to be that close. After considerable discussion, a consensus opinion was that a fiduciary breach had not yet occurred. Only if the trustees took no action once they discovered what Mary had done would they have breached their fiduciary duty.

Scenario #5—Trustee Delinquency

The Case

Joe is the employer co-chairman of a pension plan and one of its largest contributors. Unfortunately, the economic downturn severely affected Joe’s business. He has been delinquent to the pension plan numerous times over the past three years.

The collection policy of the plan calls for liquidated damages to be imposed and collected whenever an employer is two or more months delinquent. The collection policy does permit the trustees to forgive liquidated damages once based upon an appeal by the employer. The policy does not permit forgiveness of interest on delinquencies.

Joe has had liquidated damages and interest removed on three occasions. Each time, the trustees have approved the removal based on the facts that Joe paid the delinquency due in full and he is one of the plans’ largest employers.

Joe has once again come to the trustees and asked for forgiveness of liqui-
dated damages and interest and has delivered a check for the full amount of all delinquencies.

The Discussion

The basic question asked in this scenario was whether the plan should enforce its collection policy or whether the collection policy should be relaxed to forgive liquidated damages and/or interest. An overwhelming majority of the audience (73%) said the collection policy should be enforced. The majority of the audience did not think that Joe being one of the largest employers should be given any consideration. Others agreed strongly that preferential treatment should never be given to a trustee who is delinquent. Consensus seemed to be that if the policy is too stringent it should be amended but the existing policy should always be enforced.

Conclusion

The scenarios and the discussion following allowed many points of view to be shared. The audience response system demonstrates that not every trustee will have the same point of view in looking at a given situation. One participant said, “It’s simple; the right answer is just common sense.” However, one person’s perception of common sense may be different from another person’s perspective. That’s why these situations are called two-hat dilemmas.

Peter F. Castellarin is the chief executive officer of M&O Insulation and M&O Environmental Companies, the largest insulation and asbestos removal contractor in the Chicago market. He also serves as president and member of the executive board of the Illinois Regional Insulation Contractors Association and as a member of the Insulators Local 17/Illinois Regional Insulation Contractors Association Joint Trade Board. Castellarin sits on the board of directors of the National Union Insulation Contractors Alliance and serves as president of that organization. He is a management trustee for the Insulators Local 17 Welfare, Pension and Annuity Funds. In addition to serving as a speaker and moderator for the International Foundation, Castellarin is a member of the Financial Review Committee. He graduated from De Paul University with a B.S. degree in commerce. Castellarin holds a CPA designation and is a graduate of the John Marshall Law School.

William A. Martin is a professional trustee providing fiduciary services to Taft-Hartley and single employer plans. He has 30 years’ experience in the employee benefits field. Martin is a 40-year member of International Brotherhood of Electrical Workers Local 654 where he served as chairman of the health and welfare and pension committees. He is a Past President of the International Foundation and currently is a member of the Foundation’s Strategic Initiative Steering Committee.

Andrew E. Staab is a shareholder in the St. Paul, Minnesota law firm of Felhaber, Larson, Fenlon & Vogt, P.A., providing litigation and administrative support for Taft-Hartley fringe benefit funds. He specializes in ERISA, debtor-creditor, bankruptcy and general civil litigation with 23 years of multiemployer benefit experience. Staab formerly was an instructor in business law and credit law at the National Association of Credit Management, North Central Region. He serves as a member of the International Foundation’s Professionals Committee. Staab received his J.D. degree from William Mitchell College of Law and B.A. and M.A. degrees from Indiana University.