

## BAD BLOOD BOOMERANGS AGAINST FIDUCIARY

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A 401(k) participant, Edward Klepeis, sued J&R Equipment, Inc., its 401(k) plan, and Joseph T. Falanga, the company's sole owner. The legal case was simple. Mr. Klepeis was a participant in the J&R Equipment, Inc. 401(k) Plan and Trust (the "Plan"). He resigned in January of 2005 and at that time requested a rollover distribution of his vested account. After multiple requests, he still had not gotten his distribution, and in January of 2010 he filed a lawsuit in Federal Court in New York. The court Opinion and Order, dated February 9, 2012, awarded him his Plan entitlement, and in addition awarded him prejudgment interest, and attorneys' fees and costs. The case is a suitable object lesson for fiduciaries of small plans.

J&R Equipment is a small company, wholly owned by Mr. Falanga. In 2001, Mr. Falanga offered to help Klepeis build a new home on land purchased by Klepeis. Klepeis agreed to reimburse Falanga for the cost of labor and materials. The house was completed in the Fall of 2002, and in December, 2003 Falanga presented Klepeis with an invoice for \$301,500. Ultimately, Falanga accepted payment of \$298,451.50 in full satisfaction of the invoice.

After Klepeis resigned, in January 2005, he asked Falanga to rollover his Plan balance into an IRA. Falanga didn't respond. Klepeis complained to the third-party administrator, which said it could not rollover his balance without direction from Mr. Falanga, which it never received. The court ruled that Falanga's refusal to approve the rollover was a breach of fiduciary responsibility. The result seems obvious.

Why did Falanga resist? The opinion doesn't answer that question in so many words, but it does indicate that in May of 2006, Falanga sued Klepeis in New York state court demanding additional payment of over \$300,000 relating to the house he built for Klepeis. That lawsuit is still pending. Bad blood could be the answer.

In 2006, Klepeis wrote to Falanga demanding account statements and forms. In January of 2007, using forms that Falanga supplied, Klepeis submitted a written rollover request. Falanga denied the 2007 rollover request because it was not received "before the end of the valuation year," and said that Klepeis

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failed to submit the request before the end of the 2006 plan year, December 31, 2006.

In July of 2008 Klepeis submitted a second written rollover request to Falanga. Sometime in the summer of 2008, Falanga made an application to the Internal Revenue Service about terminating the plan and claimed that as a result all plan funds were frozen.

As of December 31, 2005, the end of the plan year when he made his first request, Klepeis's vested account balance totaled \$63,936.41. That account balance should have been rolled over then.

The court dutifully considered the legal issues dealing with prejudgment interest and attorneys' fees.

### *Prejudgment Interest*

Citing a Second Circuit case, *Slupinski v. First Unum Life Ins. Co.*, the opinion specifies four factors to be considered in making a decision about awarding prejudgment interest: "(1) the need to fully compensate the wronged party for actual damages suffered, (2) considerations of fairness and the relative equities of the award, (3) the remedial purpose of the statute involved, and/or (4) such other general principles as are deemed relevant by the court."

As to full compensation, the court noted that prejudgment interest is particularly appropriate as a means of ensuring that successful ERISA claimants are made whole and that defendants do not profit by their failure to comply with their ERISA obligations.

The court considered such an award fair and equitable, noting that Falanga had a whole year to authorize Klepeis's request before the year-end deadline following his termination and his first request. Not approving the request was a breach of his fiduciary duty. Falanga's subsequent actions were no better. Awarding prejudgment interest was in the interest of fairness.

As to the remedial purpose of the statute, the court observed that the central objective of ERISA is protecting employees' justified expectations of receiving the benefits their employers promise them.

The court pointed out that there is no federal statute setting a prejudgment interest rate, that the rate depends on the circumstances of the case, and that the aim is to make the plaintiff whole, but not to give them a windfall. The court granted Klepeis leave to submit his proof in support of his entitlement.

### *Attorneys' Fees*

The court noted that ERISA gives district courts discretion to award attorneys' fees, and cited a Second Circuit case, *Chambless v. Masters, Mates & Pilots Pension Plan*, which indicates that in making a decision whether to award

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attorneys' fees, the court should consider "(1) the degree of the offending parties' culpability or bad faith, (2) the ability of the offending party to satisfy an award of attorneys' fees, (3) whether an award of fees would deter other persons from acting similarly under like circumstances, (4) the relative merits of the parties' positions, and (5) whether the action conferred a common benefit on a group of pension plan participants.

The court had no trouble observing that a losing defendant is culpable if it "violated ERISA, thereby depriving plaintiffs of rights under a pension plan and violating a Congressional mandate." The court observed that this standard necessarily involve consideration of the merits of the case, and thus of the first and fourth *Chambless* factors together. Moreover, Falanga's actions seem to have coincided with the unrelated dispute with Klepeis, and Falanga ignored his fiduciary duty for a long time and in the face of repeated rollover requests, suggesting a degree of culpability beyond simply failing to do what ERISA requires.

As to the second factor, ability to pay, the court observed that both parties agree, "indeed in the exact same wording, that Defendants have that ability" (in a sharp footnote the opinion states "As Defendants' counsel in Defendants' brief seems to have copied large swaths of Plaintiff's opening brief, the court can only guess if Defendants really agree with Plaintiff's position or carelessly failed to indicate disagreement").

As to deterrence, the court pointed out Falanga's repeated failures to approve requests, and that an award of attorneys' fees should contribute to deterring other plan fiduciaries from similar violations.

The main takeaway from the opinion, in this writer's judgment, is the folly of allowing bad blood to seek a remedy, rather than dispassionate justice.

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