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## Legal News

### **Fiduciary Responsibility**

#### **Court Says Employers Can Sue Agent For Taking Excessive Commissions From Plan**

A group of employers who once participated in a now-defunct multiple employer benefit plan can continue with their claim that an insurance agent breached his fiduciary duties by extracting excessive commissions from the employers without their knowledge or approval, the U.S. District Court for the District of New Jersey ruled Sept. 26 in an unpublished decision (*National Security Systems Inc. v. Iola*, D.N.J., No. 00-6293 (AET), unpublished 9/26/07).

Judge Anne E. Thompson issued several decisions that same day addressing various motions filed in a lawsuit that arose after the Internal Revenue Service disqualified for favorable tax treatment a multiple employer benefit plan known as the Employers Participating Cooperative (EPIC) plan.

The EPIC plan was created in 1986 by Tri-Core Inc. The plan was intended to comply with ERISA by providing a "10 or more employer plan." The plan provided pre- and postretirement death benefits and allowed for conversion to individual policies with the ability to borrow against the policy. At its peak in 1998, 350 companies participated in the EPIC plan.

Tri-Core's owner met in 1989 with two insurance agents--James W. Barrett, who worked for CIGNA Financial Advisors Inc., and Gerard T. Papetti, an agent for U.S. Financial Services Corp. These two agents began selling the EPIC plan to employers, repeatedly assuring those employers that contributions to the plan were tax deductible.

#### **Plan Disqualified**

In 1995, IRS disqualified the EPIC plan for favorable tax treatment after finding that the plan was not a "10 or more employer plan" entitled to favorable tax treatment because the plan was designed for multiple employers. Numerous lawsuits were later filed, including one by Finderne Management Co., which had purchased the plan at the suggestion of Barrett and Papetti. Finderne filed its lawsuit against Barrett, Papetti, and others in a New Jersey state court, contending they had made misrepresentations about the tax benefits of the EPIC plan.

In November 2002, the New Jersey Superior Court, Appellate Division, ruled that the Employee Retirement Income Security Act did not preempt Finderne's claim that Barrett and Papetti misrepresented to them the potential tax benefits of the EPIC plan. The state court reasoned that the misrepresentations were made before the plan was purchased by Finderne and thus ERISA was not implicated (229 PBD, 2/27/02; 29 BPR 3125, 12/3/02; 29 EBC 1647).

Several other employers who purchased the EPIC plan, including National Security Systems Inc., filed their own lawsuit in federal court asserting various claims under ERISA

The employers alleged, among other things, that Barrett and Papetti breached their fiduciary duties by inducing them to participate in the plan, by making misrepresentations about the existence of an alleged "reserve fund," and by paying themselves excessive commissions out of the plan's funds.

#### **Nonfiduciary Status**

In one of several decisions issued by the court Sept. 26, the court denied in part Barrett's motion for summary judgment on the plaintiffs' claim that Barrett should be held liable as a nonfiduciary for making misrepresentations about the plan. In his motion, Barrett argued that he could not be held liable under ERISA as a nonfiduciary because he was not an ERISA "party in interest" and did not participate in a prohibited transaction. According to the court, the liability of a nonfiduciary does not depend on whether that nonfiduciary can be classified as a party in interest or whether the nonfiduciary participated in a prohibited transaction.

The court also rejected Barrett's argument that the claims against him should be dismissed because the plaintiffs sought money damages in the form of either benefit-of-the-bargain damages, or the return of the allegedly excessive commissions, which were not "appropriate equitable relief" under ERISA Section 502(a)(3). While Barrett argued that the commissions represented his "fair compensation" and thus were not subject to equitable restitution under Section 502(a)(3), the court noted that the plaintiffs sought to recover contributions they allegedly made to what they were told was a "reserve fund" and that it was from this fund that commissions were wrongfully misappropriated by Tri-Core to Barrett and others. The court thus found that the plaintiffs were seeking permissible and appropriate equitable relief under Section 502(a)(3).

The court also rejected Barrett's assertion that the plaintiffs' ERISA claims against him were time-barred because the alleged fiduciary breach occurred when the purported misrepresentations about the tax benefits of the EPIC plan were made. The court instead agreed with the plaintiffs that their claim was that the defendants extracted excessive commissions from the "reserve fund" without the plaintiffs' knowledge or approval and that they lacked knowledge about this breach until well within the three years before the ERISA claims were filed in December 2000.

The court went on to find that any misrepresentations made by Barrett prior to the time the employers purchased the EPIC plan were not preempted by ERISA, but any misrepresentations made after the purchase of the plan were actionable under ERISA.

### **Employers' Summary Judgment Motion Denied**

In another opinion issued by Judge Thompson Sept. 26, the court denied motions for summary judgment filed by several of the plaintiff employers. As to the employers' claims against Barrett and another agent, Robert L. Iola Jr., the court said there were a number of genuine issues of material fact as to whether Barrett and Iola misrepresented the tax advantages of the EPIC plan, misrepresented the existence of a "reserve fund," and misappropriated excessive commissions from plan contributions.


The court said Barrett had presented evidence that the employers "were unreasonable in believing that any 'reserve fund' existed and the commissions he earned were neither secret nor excessive, but properly owed to him" for his sales of the EPIC plan.

### **Liability of Agents' Employers**

In a separate opinion issued the same day, the court denied in part a motion to dismiss by CIGNA Financial Advisors Inc. and Lincoln National Life Insurance Co., who had employed Barrett and other insurance agents who sold the EPIC plan. CIGNA and Lincoln argued that they had no connection with the EPIC plan and that the agents had sold the EPIC plan on behalf of Tri-Core without authority from CIGNA and Lincoln.

The court said genuine issues of material fact existed as to the agents' true roles in recommending the EPIC plan to the employer, and as to whether CIGNA and Lincoln were aware and approved their actions in doing so.

The plaintiffs were represented by Steven J. Fram and Mark J. Obersteadt of Archer & Greiner, Haddonfield, N.J. The defendants were represented by Ellen Nunno Corbo of Taylor Colicchio & Silverman, Princeton, N.J.; Richard M. Carnall of Reger, Rizzo, Kavulich & Darnall, Mount Laurel, N.J.; Robyn M. Gnudi of Seiden Wayne, Newark, N.J.; Christopher Phillip Leise of White & Williams, Cherry Hill, N.J.; and B. John Pendleton Jr. of McCarter & English, Newark, N.J.

The full text of the opinions can be found at <http://pub.bna.com/pbd/006293.pdf>, <http://pub.bna.com/pbd/006293a.pdf>, and <http://pub.bna.com/pbd/006293b.pdf>. 

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