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401(k) Termination Fees and Expenses: Must the Bankruptcy Estate Foot the Bill?

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Bankruptcy trustees may occasionally find themselves having to undertake the task of terminating a debtor employer's retirement plan, such as a deferred compensation plan established for tax purposes pursuant to 26 U.S.C. §401(k). Because it requires specialized expertise, this process may involve significant costs. For instance, it may require the trustee to retain professionals such as attorneys, accountants and professional retirement planners. All parties involved—the trustee, creditors, former employees and professionals—will likely ask: Who will pay for the fees and expenses associated with termination of the retirement plan? Rather than charge the bankruptcy estate, the trustee could argue that the assets of the retirement plan—non-estate property—should bear the costs. Indeed, the terms of the applicable retirement plan, certain provisions in the federal statute governing retirement plan and the common law of trusts may each support this argument. Further, even assuming that the bankruptcy estate must bear the costs, the trustee should argue that, at the very least, the claim for such costs does not qualify for administrative priority under the Bankruptcy Code. This article briefly examines the grounds for this argument.

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Terms of the Retirement Plan

First, the terms of the retirement plan might expressly authorize the trustee to compensate counsel, specialists, advisers, agents and other persons from the assets of the plan. For example, in *In re B.B. Walker Co.,* a 401(k) plan administrator entrusted by two debtor employers with terminating their 401(k) plans sought reimbursement from the debtors' bankruptcy estates for professional fees incurred in connection with the

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termination. 2002 WL 31770849 at *1 (Bankr. M.D.N.C. Nov. 25, 2002). In rejecting the argument that the debtors' bankruptcy estates had an obligation to pay the fees, the court noted that although the debtors had apparently paid most of the plan administrative fees prior to bankruptcy, the plans did not obligate the debtors to make these payments. *Id.* at *2. Rather, the court noted, the plans expressly provided that expenses related to the performance of the plan trustee's duties or the administration of the plans shall be paid by the plans unless paid by the employer. *Id.* Thus, the court concluded that this language did not impose any contractual duty or obligation upon the debtors. *Id.* It further concluded that the debtor's voluntary payment of plan expenses did not override the language of the plans and create a legal obligation on the part of the debtors to pay expenses incurred by the plan trustee. *Id.*

Similarly, in *In re Carolina Premier Med. Group P.A.,* a bankruptcy trustee sought to pay special counsel retained by the debtor to provide legal advice and representation with respect to termination of a 401(k) plan. 2003 WL 1751257, at *1 (Bankr. M.D.N.C. Mar. 31, 2003). A bankruptcy administrator objected on the basis of language in the 401(k) plan providing that legal fees and expenses shall be paid first from any forfeitures, and then from the remaining trust fund, unless such expenses have been paid by the employer. *Id.* The bankruptcy administrator maintained that special counsel's services should be paid from the plan's forfeitures or trust fund and not as costs of administration of the debtor's estate. *Id.* The court agreed, finding that the language of the plan did not impose any contractual duty or obligation upon the estate to pay for the expenses incurred by the plan. *Id.* at *2. While the plan did provide that the employer may pay such costs, the court observed, it was determined that the trust fund bore the ultimate responsibility for payment of the costs of administration. *Id.*

In contexts other than termination, courts have, consistent with the terms of the governing plan, likewise required plan assets to pay for general administration costs such as attorney's fees. *See, e.g., Engelhart v. Consolidated Rail Corp.,* 1996 WL 526726, at *11 (E.D. Pa. Sept. 18, 1996) (observing that "all administrative expenses could be paid from the plan's trust fund without violating the requirements of the plan itself or the general provisions of [the governing statute]," where the plan provided that the

employer shall pay all pension-associated expenses, "except to the extent such expenses are paid from the trust fund"), *aff'd,* 127 F.3d 1095 (3d Cir. 1997), *cert. denied,* 522 U.S. 1147, *leave to file for reh'g denied,* 524 U.S. 963 (1998); *Haberern v. Kaupp Vascular Surgeons Ltd. Defined Benefit Plan and Trust Agreement,* 822 F. Supp. 247, 263-64 (E.D. Pa. 1993) (holding that deduction of administrative fees from retirement plan participant's accounts was not inappropriate where plans in question provided that "[a]ny reasonable expenses incurred in the administration of this Trust shall be chargeable to and paid by the Trust Fund, provided that the employer may pay all or any part of such expenses, but shall have no obligation to do so"), *motion to amend denied,* 151 F.R.D. 49 (E.D. Pa.), *judgment rev'd in part,* 24 F.3d 1491 (3d Cir. 1994), *cert. denied,* 513 U.S. 1149 (1995). *See also Citrin v. Erikson,* 918 F. Supp. 792, 803 (S.D.N.Y. 1996) (holding that award of attorney fees to trustees could be satisfied from trust fund because trust agreement authorized trustees to use and apply trust fund to pay for such fees).

In other cases in which the applicable plan obligated the employer to pay administration costs, courts have ruled to the contrary. *See, e.g., DelGrosso v. Spang & Co.,* 776 F. Supp. 1065, 1070 (W.D. Pa. 1991) (noting that plan obligated employer to reimburse plan administrator for expenses), *aff'd,* 968 F.2d 12 (3d Cir. 1992); *In re Gulf Litig.,* 764 F. Supp. 1149, 1207 (S.D. Tex. 1991) (holding that employer violated duties of loyalty and care when it paid expenses of outside investment managers from employer's pension plan assets, where plan provided that such expenses shall be paid by the employer), *aff'd, Borst v. Chevron Corp.,* 36 F.3d 1308 (5th Cir.), *reh'g denied,* 42 F.3d 639 (5th Cir. 1994), *cert. denied,* 514 U.S. 1066 (1995). Thus, assuming that the governing retirement plan does not obligate the debtor to pay for termination costs, a bankruptcy trustee should argue that the assets of the plan should bear the costs.

ERISA Provisions

Second, a bankruptcy trustee could argue that the Employee Retirement Income Security Act (ERISA), the statute governing retirement plans, expressly authorizes the payment of termination costs from plan assets. For instance, §1103(c)(1) of Title 29 provides that "the assets of a [401(k)] plan...shall be held for the exclusive purpose...of...defraying reasonable expenses of administering the plan." 29 U.S.C. §1103(c)(1). The *Carolina* court found that the reasonable expenses of administering a plan include direct expenses properly and actually incurred by a fiduciary in the performance of duties to the plan, such as those performed by a bankruptcy trustee as plan administrator. *Carolina,* 2003 WL 1751257, at *3. Further, it found that the services required to actually implement an employer's decision to terminate a plan qualify generally as fiduciary in nature. *Id.* Therefore, the court concluded, the expenses associated with these services may be paid from the plan. *Id.*

Applying this analysis, the *Carolina* court determined that the majority of the fees and expenses incurred by the trustee's special counsel constituted costs related to administering the 401(k) plan pursuant to §1103(c)(1). *Id.* at *3-4. Services included executing termination documentation, providing notice to interested parties, making distributions, maintaining tax-qualified status and obtaining an Internal Revenue Service determination concerning the status of the plan in connection with termination. *Id.* at *4. Hence, the court concluded, such fees and expenses could be paid from the plan assets. *Id.* at *3-4. The court held that the remaining fees and expenses, however, deriving from decisions and activities related to management of the plan, constituted "settlor expenses" benefiting the bankruptcy estate and hence payable from the estate. *Id.*

Similarly, the *Walker* court found that the 401(k) plan administrator had incurred fees and expenses in connection with termination of the debtors' 401(k) plans in order to make distributions to the beneficiaries of the plans. *Walker,* 2002 WL 31770849, at *3. Thus, the court found, the fees and expenses benefited the beneficiaries and warranted payment from the plans pursuant to §1103(c)(1). *Id.*

Additional ERISA sections arguably support a trustee's argument that the plan assets should bear the cost of termination. For example, §1108(c) provides that a fiduciary under a retirement plan "may receive any reasonable compensation for services rendered, or for the reimbursement of expenses properly and actually incurred, in the performance of his duties with the plan." 29 U.S.C. §1108(c). Also, §1104(a)(1)(A)(ii) provides that "a fiduciary [under a retirement plan] shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and for the exclusive purpose of defraying reasonable expenses of administering the plan." 29 U.S.C. §1104(a)(1)(A)(ii).

Common Law of Trusts

Next, in enacting ERISA, Congress invoked the common law of trusts to define the trustee's general duties and responsibilities. *IAM Stock Ownership Inv. Trust Fund v. Eastern Air Lines Inc.,* 639 F. Supp. 1027, 1034 (D. Del. 1986). Under the common law of trusts, trustees have powers necessary or appropriate to carry out the purposes of the trust. *Id.* (*citing Central States, Southeast and Southwest Areas Pension Fund v. Central Transp. Inc.,* 472 U.S. 559 (1985)). According to the Restatement (Second) of Trusts, "[a] trustee can properly incur expenses which are necessary or appropriate to carry out the purposes of the trust and are not forbidden by the terms of the trust, and such other expenses as are authorized by the terms of the trust." *Id.* (*quoting* Restatement (Second) of Trusts §188 (1959)). The *IAM* court cited these principles in support of its finding that a trust fund could pay for expenses incurred in connection with operation and administration of the trust. *Id.* Thus, a bankruptcy trustee could argue that the common law of trusts supports the proposition that a 401(k) plan itself should pay for termination costs so long as the costs were incurred solely for the benefit of the plan and its participants.

Administrative Priority

Finally, even assuming that 401(k) plan participants can establish that bankruptcy estate assets, and not the 401(k) plan assets, should serve as the source for the payment of termination costs, a bankruptcy trustee should argue that, at the very least, the claim for such costs should not be entitled to administrative priority. While the Bankruptcy Code authorizes a court to allow the payment of administrative expenses, including the actual, necessary costs and expenses of preserving the estate, 11 U.S.C. §503(b)(1)(A), courts have established demanding criteria for determining whether a claim qualifies for an administrative priority. *In re G-1 Holdings Inc.,* 308 B.R. 196, 202 (Bankr. D. N.J. 2004). In order to protect other creditors, courts narrowly construe allowances for administrative expenses. *Id.* The administrative expense priority applies only to those claims for costs actually and necessarily incurred in the

preservation of the estate for the benefit of its creditors. *Id.* In order for an expense to qualify as "actual" and "necessary," the claim must benefit the estate as a whole. *Id.*

In *Walker,* the court refused to allow an administrative expense claim for the payment of fees incurred in connection with termination of a debtor's 401(k) plan. *Walker,* 2002 WL 31770849, at *3-4. The court reasoned that because the assets of an ERISA plan are held solely for the benefit of the plan participants and their beneficiaries and not for the benefit of the employer, the debtors' bankruptcy estates had not benefited from the administration and distribution of such assets. *Id.* at *4.

Conclusion

A bankruptcy trustee could potentially raise contractual, statutory and common law grounds for the proposition that 401(k) plan assets themselves, rather than bankruptcy estate assets, should bear the 401(k) termination costs. Moreover, even assuming that the bankruptcy estate is liable, the trustee should argue that the claim for such costs is not entitled to administrative priority. ■

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