In the Matter of:

**U.S. DEPARTMENT OF LABOR,
PENSION AND WELFARE BENEFITS
ADMINISTRATION,**

Complainant/Cross-Appellant

v.

**SPALDING AND EVENFLO
COMPANIES, INC.,**

Respondent/Appellant

Date: Nov. 18, 1994

CASE NO. 92-RIS-19

DECISION AND ORDER

This proceeding is on appeal from the United States Department of Labor, (hereinafter "the Department" or "DOL") Office of Administrative Law Judges, and arises under Sections 2, 101, 103, 104, 502(c)(2) and 505 of the Employee Retirement Income Security Act of 1974 (ERISA), as amended (29 U.S.C. Sec. 1001, 1021, 1023, 1024, 1132(c)(2) and 1135), and the implementing regulations at 29 C.F.R. Sec. 2520.104-44, 2560.502c-2, and 2570.60 - 2570.71.

BACKGROUND

Each of the three welfare plans which are the subject of this case provided health, dental, life and accidental death and dismemberment benefits for employees of divisions of Spalding and Evenflo Companies, Inc., Respondent-Appellant (hereinafter "Spalding"). The plans were the Spalding and Evenflo Companies, Inc. -- Plan Code FF, the Spalding Corporation Group Insurance for Plant, Office and Sales -- Plan AA, and the Spalding and Evenflo Companies, Inc. - - Plan H.[1] Each of these plans has in excess of 100 participants.,

The medical plans were paid for by Spalding until July 1, 1988, when employees began making contributions. Life insurance in the amount of the employee's salary was paid for by Spalding, and employees had an option of paying for an increase in benefits.

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[1] The opinion of the Administrative Law Judge refers to Plan H as Plan HH, repeating an inadvertent error in the joint stipulation of the parties.

Employee contributions to the plans for medical benefits, which began on July 1, 1988, ranged from $12 to $30 per month depending upon coverage. The plans were funded by Spalding and administered by Prudential Insurance Company. Employee contributions to the plans totalled $140,000 in 1988, and Spalding's contributions totalled approximately $2,700,000. Audits for 1988 by Deloitte & Touche which were submitted to the Department on February 25, 1992 showed that the three plans had combined total assets, including unreimbursed claims, of $521,000.

In 1988, absent an applicable exemption from ERISA's reporting requirements, Plans AA, FF and H each required an annual report containing an opinion of an independent qualified public accountant based on an audit of the plan because each plan was funded and covered over 100 employees. The 1988 annual report for each plan was due on July 31, 1989.

On February 19, 1991, the DOL notified Spalding that the annual reports filed for 1988 for the three plans were deficient because these plans were not exempt from the requirements that plans with 100 or more participants must attach a report of an independent qualified public accountant, and such reports had not been attached.

On March 21, 1991, Spalding submitted an amended Form 5500 for each of the plans, containing a report by the accounting firm of Deloitte & Touche, based on an audit of the bank account which held the assets of the three plans. On September 23, 1991, the DOL issued notices of rejection of the amended 1988 annual reports, because the accountant's report was based on audit of the trust account containing the combined assets of the three plans and not for each of the individual plans, and gave notice that the Secretary of Labor may assess penalties of up to $1,000 per day unless revised reports, satisfactory to the Department, were filed within 45 days.

On December 12, 1991, the DOL issued a Notice of Intent to Assess a Penalty of $50,000 against each of the three plans[2]. On January 13, 1992, Spalding filed a Statement of Reasonable Cause why the penalties should not be assessed, and on February 25, 1992, Spalding filed an independent qualified public accountant's report for each plan which was based on a separate audit of the assets of each of the three plans. On April 1, 1992, the DOL issued its Notice of Determination with respect to reasonable cause, reducing by 25% the total penalty for the deficient filings of the three plans, from $150,000 to $112,500.

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[2] DOL calculated the penalty amount for each plan as follows. The Secretary of Labor had established a penalty level of $150 per day for a missing or deficient accountant's report. The DOL multiplied $150 per day by 864 days (the number of days between the day after the reports were due for each plan (August 1, 1989), and the date of the Notice of Intent to Assess a penalty was sent to Spalding, the administrator of each plan (December 12, 1991), which resulted in a penalty of $129,600 for each plan, which was reduced to $50,000, the maximum penalty amount set by the DOL for a missing or deficient accountant's report.

On February 1, 1993, The Honorable Judge E. Earl Thomas, District Chief Judge, (ALJ), issued a Decision and Order finding that Spalding was subject to a civil penalty under ERISA Sec. 502(c)(2) for the delayed filing of annual reports pertaining to the three employee welfare plans for plan year 1988. The ALJ found that Spalding was not in full compliance with the reporting requirements of ERISA until 864 days after the reports were due. Although Spalding argued that it made a good faith effort to comply, the ALJ found that no satisfactory explanation was provided as to why the effort to do the required audits was not attempted earlier.

The ALJ upheld the DOL's utilization of $150 per day for its calculation of the penalty, its use of $50,000 per plan cap, and the granting of a 25% reduction of penalty based on a determination of reasonable cause to waive part of the penalty with respect to the filing of the 1988 annual reports of the plans. The ALJ concluded that the three welfare plans were subject to the independent audit requirement contained in 29 U.S.C. §§1023 and were not eligible for the exemption contained in 29 C.F.R. 2520.104-44(b)(1)(ii). He further concluded that Spalding could not rely upon the DOL's failure to challenge prior years' reports as a defense against the imposition of penalties for the 1988 year, noting that this proposition has been defeated in too many cases to mention. Finally, he also concluded that Spalding had no satisfactory explanation as to why it could not come into full compliance until 29 months after the reports were originally due. However, the ALJ noted that Spalding did make an effort to comply and was in communication with the DOL, concluding that Spalding's was not an "extremely willful" violation. The ALJ concluded that the imposition of a penalty from the initial filing date "seems unreasonable" because Spalding had been filing reports without auditor's reports for years and the DOL had not issued notices of violation for earlier years, and because of Spalding's "spirit of cooperation". Without further explanation, the ALJ used as a starting point for calculation of the penalty the date on which the DOL first notified Spalding of the deficiency in the filing (February 19, 1991) instead of using as a starting point the day after the date the reports were originally due (August 1, 1989). This resulted in the subtraction of 568 days from the 864 day penalty period, resulting in a penalty amount of $44,400 for each plan. He then reduced that amount by 25%, as the DOL had done, resulting in total penalties of $99,900 for the three plans.

Spalding appealed the ALJ decision on the grounds that Spalding is exempt from the audit requirement under ERISA Technical Release 92-01, that there is no substantial evidence to support the ALJ's finding that Spalding tried to avoid full compliance with the annual reporting requirements, and that the ALJ erred in upholding the penalty because Spalding complied in good faith with ERISA annual reporting requirements. The DOL cross-appealed the ALJ decision on grounds that the ALJ improperly calculated the penalty amount by starting the computation on the day the Pension and Welfare Benefits Administration (PWBA) first sent Spalding notice of reporting deficiencies rather than from the initial filing date, and asserted that, if the ALJ found liability, as he did, the ALJ should have deferred to PWBA's reasonable method of calculation of the applicable penalty amount. The DOL also asserted that, on the facts of this case, the court had no equitable basis for substituting its judgement for the DOL in reducing the penalty amount.

I shall deal with the issues raised in the cross appeals in turn.

SPALDING'S CONTENTION THAT ERISA TECHNICAL RELEASE 92-01 EXEMPTS IT FROM ERISA's AUDIT REQUIREMENT

Spalding was required to file a Form 5500 annual report with respect to each of three welfare benefit plans, known as plan FF, plan AA, and plan H, for plan year 1988. Spalding filed annual reports for the three plans on July 31, 1989. The three reports were materially incomplete under ERISA section 103 if they were required to include a report of an independent qualified public accountant (IQPA). Spalding asserts that Technical Release 92-01 provides it an exemption from the trust requirements[3].

The basis for Spalding's position is twofold: First, it asserts that T.R. 92-01 applies retroactively, as well as prospectively, and therefore covers the 1988 plan year. It also asserts that, while there was a trust in the form of a bank account holding assets which paid plan benefits, the assets in the account held company assets, not plan assets, and therefore the bank account was not a trust maintained in connection with a plan.

T.R. 92-01, which is a statement of enforcement policy, is silent as to its effective date. Spalding argues that, once adopted, it covers prior plan years, as well as prospectively. The DOL, without explanation, states that T.R. 92-01 "was not in effect for the 1988 annual reporting year". Both Spalding and the DOL have misread the applicability of T.R. 92-01. As a statement of enforcement policy, it is applicable to all enforcement actions which the DOL may bring after the date of adoption, even if it is based, as this one is, on violations prior to 1992. Indeed, the stated purpose of T.R. 92-01 was to expand the categories of violations as to which the DOL would not assert a violation beyond the limited categories contained in T.R. 88-1. The preamble to T.R. 92-01 makes clear that its purpose is to relieve plan sponsors from "incurring significant, and possibly unnecessary, administrative costs and expenses" pending the issuance of the contemplated exemptions from the trust requirements. Therefore, it would be illogical to read the technical release to govern only enforcement actions relating to plan violations occurring after May 28, 1992, the date of the release. However, the enforcement action complained of by Spalding, the DOL's levying of a civil penalty, took place on April 1, 1992,

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[3] T.R. 92-01 provides that the Department of Labor will not assert a violation in any enforcement proceeding solely because of a failure to hold participant contributions in trust. Further, T.R. 92-01 provides that in the absence of a trust, the Department will not assert a violation in any enforcement proceeding or assess a civil penalty with respect to a cafeteria plan because of a failure to meet the reporting requirements by reason of not coming within the exemptions set forth in 29 C.F.R. 2520.104-20 and 2520.104-44 solely as a result of using participant contributions to pay plan benefits or expenses attendant to the provision of benefits. T.R. 92-01 also provides that in the case of any other contributory welfare plan with respect to which participant contributions are applied only to the payment of premiums in a manner consistent with 29 C. F. R. 2520.104-20(b)(2)(ii) or (iii) and 2520.104-44 (b)(1)(ii) or (iii), as applicable, the Department of Labor will not assert a violation in any enforcement proceeding or assess a civil penalty solely because of a failure to hold participant contributions in trust.

which was prior to the adoption of T.R. 92-01. Nothing in T.R. 92-01 indicates that it was meant to invalidate prior enforcement proceedings. Therefore, T.R. 92-01 is not available to provide relief.

However, even if T.R. 92-01 were applicable to this enforcement proceeding, the record below indicates that the exemption from the IQPA report contained in T.R. 92-01 was not available for the Spalding plans. The parties appear to agree that there was a trust fund which contained assets related to the three plans (see joint stipulations 7 and 9). Spalding's appeal argues that the plans were unfunded cafeteria plans eligible for the exemption contained in T.R. 92-01. However, as Spalding recognizes, a predicate for the availability of the exemption contained in T.R. 92-01 is that the plan be unfunded. Spalding contends that the bank account maintained in connection with the plans at Ohio Citizens Bank was not a trust maintained in connection with the plans because Spalding asserts that it did not contain plan assets, but rather company money, as characterized by the plans' accountants for purposes of conducting the audits of the plans. However, Spalding misses the essential point -- once the monies were deposited in a separate account for the plans pursuant to an "insurance trust agreement" with Ohio Citizens Bank as trustee, the assets in that account were plan assets, regardless of whether the monies in the account were monies derived from employer contributions or employee contributions. T.R. 92-01 is predicated on the absence of a trust containing plan assets. Here there was a trust, in which all three plans had an interest, as Spalding itself recognized, in filing the Forms 5500s and in the pre-hearing statement filed with the ALJ (p.18). Therefore, even if T.R. 92-01 were available to void enforcement actions taken before its promulgation, Spalding could not satisfy its substantive requirements.

SPALDING'S CONTENTION THAT THERE IS NO SUBSTANTIAL EVIDENCE TO SUPPORT THE ALJ'S CONCLUSION THAT SPALDING TRIED TO AVOID FULL COMPLIANCE WITH THE ANNUAL REPORTING REQUIREMENTS.

Spalding contends on appeal that the ALJ did not have substantial evidence to support his conclusion that Spalding tried to avoid full compliance with the annual reporting requirements. This misrepresents the finding of the ALJ, which was that Spalding did not provide satisfactory evidence as to why its accountants did not prepare separate plan audits earlier. The burden, under the regulations, is not that the ALJ find that Spalding did not proceed in good faith to comply, but rather that Spalding must demonstrate, to the satisfaction of the ALJ, that it proceeded in good faith to comply. As the preamble to the final regulation notes, the Department regulations "substantially reduce the possibility of a penalty being imposed on an administrator *who demonstrates* good faith and diligence in complying with ERISA's annual reporting requirements" (italics added). Thus, the issue before the ALJ was whether Spalding, having been found to have filed a materially deficient statement, demonstrated to the ALJ that it demonstrated good faith and diligence in coming into compliance with ERISA's audit requirements. The evidence before the ALJ fully supports his conclusion that "there was no satisfactory explanation as to why this final successful effort by Deloitte & Touche was not attempted earlier". Among that evidence was the Notices of Rejection sent to each individual plan in February 1991, requiring a report of an independent qualified public accountant as required by 29 C.F.R. 2520.103-1(b), i.e., a report as to the assets of each plan, and the testimony of the responsible Spalding official that the plans' accountants were directed to do an audit of the trust, not of the plans (Hearing Transcript, pp. 161-163). While there is some disagreement between the parties as to whether the DOL had indicated to Spalding that such an audit would be appropriate, it was for the ALJ to determine the credibility of the witnesses and to weigh the evidence before him. There was more than sufficient evidence before him to determine that Spalding did not satisfy its burden of showing good faith and diligence in coming into compliance.

SPALDING'S CONTENTION THAT THE ALJ ERRED IN UPHOLDING THE PENALTY BECAUSE SPALDING IN GOOD FAITH FULLY COMPLIED WITH ERISA'S ANNUAL REPORTING REQUIREMENTS

This argument is rejected for the reasons set forth in response to Spalding's second contention, above. The record contains more than sufficient evidence to support a conclusion by the ALJ that Spalding did not make a good faith effort to comply. Therefore, the evidence amply supports a conclusion that Spalding failed to satisfy its burden of proving to the court that it made a good faith effort to comply.

I now turn to the contentions contained in the DOL's cross-appeal.

THE DOL's CONTENTION THAT THE ALJ IMPROPERLY CALCULATED THE PENALTY AMOUNT BY STARTING THE COMPUTATION ON THE DAY THE DOL SENT SPALDING NOTICE OF REPORTING DEFICIENCIES, RATHER THAN ON THE FILING DATE

By failing to timely file the required IQPA report for each of the three welfare plans in question, Spalding is subject to a civil penalty of up to $1,000 per day per plan under ERISA Sec. 502(c)(2). The implementing regulations thereunder provide that the penalty amount shall be "computed from the date of the administrator's failure or refusal to file the annual report... continuing up to the date on which an annual report satisfactory to the Secretary is filed[4]."

The regulations define the date on which the administrator failed or refused to file as the "date on which the annual report was due (determined without regard to any extension for filing)[5]." In Spalding's case, the date on which the penalty calculation must begin is August 1, 1989, the day after the original July 31, 1989 filing deadline for the Forms 5500s. The regulations do not provide for deviations from this starting date for penalty calculations. The regulations do permit a tolling of time for calculating penalty amounts in situations in which the plan administrator files a statement of reasonable cause after receiving notice that the Department intends to assess a penalty, stating that "a penalty shall not be assessed for any day from the date the Department serves the administrator with a copy of [a notice of intent to

4 29 C.F.R. 2560.502c-2(b)(1).

5 29 C.F.R. 2560.502c-2(b)(3).

assess a penalty] until the day after the Department serves notice on the administrator of its determination on reasonable cause and its intention to assess a penalty[6]."

The regulations require, therefore, that Spalding's penalty amount be calculated using a figure of 864 days per plan, which is based on a starting date of August 1, 1989 (the day after the date on which the annual reports were due) and an ending date of December 12, 1991 (the date the PWBA issued its Determination of Reasonable Cause and Notice of Intent to Assess a Penalty).

The regulations adopted by the DOL at 29 C.F.R. 2560.502c-2 to implement the provisions of sections 104(a)(4) , 104(a)(5), and 502(c)(2) of ERISA are entitled to deference, unless the implementation exceeds the agency's authority or is unreasonable. Nowhere in the ALJ's decision or in Spalding's appeal is there any indication that the DOL's implementing regulations are unreasonable. The ALJ's decision is totally silent as to the issue, as is Spalding's appeal, which argues that the ALJ, pursuant to its de novo authority, could do whatever it wanted to in assessing a penalty, based on the evidence before it. This is correct insofar as the ALJ has the power to try facts de novo. However, in deciding issues of law, the ALJ is bound by the governing statute and regulations, except to the extent he finds them to be invalid[7]. The ALJ's reduction in penalty amount, based on his altering the starting date for computing the number of days of Spalding's lateness, goes beyond the ALJ's mandate, absent a showing that the DOL's implementing regulations exceeded its authority or was unreasonable. The regulations explicitly provide that the number of days be computed starting with the day after the date on which the filing was due. Were I to uphold the ALJ's novel calculation method, with its starting date fixed as the date on which PWBA first notified Spalding that its reports were deficient (February 19, 1991), I would be ignoring not only the specific requirements of the regulations implementing 502(c)(2), but also the fundamental nature of ERISA's reporting and disclosure requirements which form the basis for these requirements.

The burden of accurate and complete reporting and disclosure is on ERISA plan administrators and fiduciaries, who must meet the requirements of the statute and regulations thereunder. The date for complying with the annual reporting requirements is the date that the annual report is due, not the date on which a PWBA reviewer first notes a failure or deficiency.

To permit the ALJ's calculation of time in non-compliance to stand would be to shift the burden of compliance with ERISA reporting and disclosure requirements away from plan administrators and onto the DOL, by allowing plans to violate the statute and regulations without being subject to civil penalties unless and until PWBA notifies them of their violations. This shift of the burden of compliance from the plan administrator to the supervising agency is not only insupportable as a matter of law but illogical as a matter of fundamental policy.

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[6] 29 C.F.R. 2560.502c-2(b)(2).

[7] The DOL regulations governing ALJ hearings provide that "the administrative law judge shall have jurisdiction to decide all issues of fact and related issues of law". 29 C.F.R. 18.43(b)

Therefore, as a matter of law, the ALJ could not set aside the DOL's method of calculating the number of days of noncompliance.

I now come to the DOL's second contention.

THE DOL's CONTENTION THAT, ON THE FACTS AND CIRCUMSTANCES, THERE IS NO EQUITABLE BASIS FOR NOT APPLYING PWBA's PENALTY CALCULATION METHOD

The facts of this case also do not support the Court's non-application of regulation 29 C.F.R. §§2560.502c-2(b)'s penalty calculation method on equitable grounds. The Court held that "the imposition of the penalty from the initial filing date of July 31, 1989 until DOL notified the plan administrator on February 19, 1991, that the audit reports were required for each plan, seems unreasonable.". The Court also noted the respondent's "lack of prior notices of violations."

The Court, by labeling the imposition of the penalty from the filing date to be "unreasonable", implies that it is not fair to penalize someone who thinks he is in compliance until he is put on notice that he is not in compliance. Although on the surface this appears to be an appealing rationale, it is not justifiable on the basis of the facts in this case. Spalding had a 45-day penalty-free grace period provided by the statute to come into compliance. The 45-day grace period provides the element of fairness, due process, and reasonableness. Upon notice to the administrator, by means of a Notice of Rejection, that an annual report is not in compliance, the statute and the regulation provide that the administrator has 45 days within which to correct the filing defects without any exposure to penalty liability if the corrections are made within this period. The administrator is not automatically liable for a penalty stretching back to the day after the due date for the report[8].

Moreover, as the record shows[9], because this was one of PWBA's earliest cases, Spalding was issued pre-rejection notices for the three plans on February 19, 1991, seven months prior to the actual Notices of Rejection. During that time, Spalding had ample opportunity to secure a proper accountant's report for each of the plans. After the Notices of Rejection, Spalding had an additional 45 penalty-free days within which to correct. Altogether, Spalding was put on notice and had opportunity to correct approximately 8 1/2 full months before any penalty exposure would be triggered.

If, on the other hand, the court's motivation was that it believed that PWBA had not abated the penalty sufficiently to take into account respondent's "lack of prior notices of violations and spirit of cooperation," the result is inconsistent with the court's determination that Spalding "waited until the very last minute to fully comply with the reporting violations" and its finding

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[8] Furthermore, any penalty accruals are suspended during the rejection and correction process. See 29 CFR 2560.502c-2(b)(2).

[9] Transcript of Hearing, pages 42-43 and 48-51; Decision and Order, pages 2 and 3.

that DOL's 25 percent abatement of penalty was appropriate. In that case, the Court is substituting its own exercise of discretion for that of the agency charged with administering the statute, while at the same time stating that it "must yield to the expertise of the (agency] as well as its policy making responsibilities[10]."

While I find that the substitution by the ALJ of the date of notice of reporting deficiencies rather than the initial filing date for calculation of the penalty amount is impermissible as a matter of law, I also find that there is not a substantial basis in the decision of the ALJ for the ALJ substituting his judgment as to the amount of the penalty for that of the DOL. This is particularly so given the fact that he determined that the abatement percentage utilized by the DOL to reflect degree of good faith attempt to comply was appropriate, and did not find that the DOL implementing regulation setting forth the date for calculating the days in noncompliance was beyond its authority or was unreasonable.

I therefore set aside the ALJ's method of calculating the number of days on which the penalty may be assessed, and hereby order that the penalty amount as assessed by PWBA, $112,500, be paid to the U.S. Department of Labor by Spalding within thirty (30) days from the date of service of this decision. Amounts not paid by that time shall be subject to penalties and interest provided for by ERISA and its implementing regulations.

MORTON KLEVAN
Senior Policy Advisor

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10 The basis for the ALJ reduction of penalty is confusing, stating in relevant part the following:

> "In view of the circumstances, and particularly the fact that there was no indication during prior years that the 1988 report would be unacceptable, the imposition of a penalty from the initial filing date of July 31, 1989, until DOL notified the plan administrator on February 19, 1991, that audit reports were required for each plan, seems unreasonable. Although the law has been in effect for many years, Spalding should be given some consideration for its lack of prior notices of violations and spirit of cooperation. Thus, a total of 568 days are subtracted from the 864 previously indicated, leaving 296 penalty days. The $150 per day assessed by DOL results in a penalty of $44,400 for each plan or a total of $133,200. There is no basis for finding that the 25 percent reduction by DOL is inappropriate, and the undersigned must yield to the expertise of the Pension and Welfare Benefits Administration as well as its policy making responsibilities."