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TOPIC: Abuse of Discretion in Administration of 419 Plan

CITATION: [Regional Employers' Assurance Leagues Voluntary Employees' Beneficiary Association Trust v. Castellano](#), Civil Action No. 03-6903 (U.S. D. C., E. Dist. PA, August 25 2015).

SUMMARY: This is yet another case arising out of the aggressive Section 419 plan structure known as the "REAL VEBA" promoted and administered by John Koresko, a Pennsylvania attorney and CPA. We previously reported on a case imposing penalties on Mr. Koresko for false statements he made in promoting the REAL VEBA as an abusive tax shelter. This case addresses Mr. Koresko's abuse of discretion in the administration of the plan. After a 10-year legal battle, a beneficiary of the REAL VEBA (the wife of a deceased participant) successfully overturned the denial of death benefits by the plan administrator (Koresko's organization) as an abuse of discretion.

RELEVANCE: Although the courts will generally defer to the discretion of plan administrators in interpretation of an ERISA plan, this case illustrates how a court will sometimes stretch to overturn the exercise of discretion of the plan administrator if the court feels that a plan beneficiary has been subjected to a gross injustice.

FACTS: Dr. Castellano was a dentist. In 1998, his dental practice joined the Regional Employers' Assurance Leagues Voluntary Employees' Beneficiary Association (the "REAL VEBA"). He named his wife as beneficiary under the death benefit plan. The REAL VEBA purchased a life insurance policy on Dr. Castellano's life and named the REAL VEBA as the beneficiary. Penn-Mont, an entity set up and controlled by Mr. Koresko, was the REAL VEBA plan's administrator.

Dr. Castellano died in June 2003. The REAL VEBA received a check from the life insurance company in the amount of \$751,266.18. Mrs. Castellano submitted a claim for the \$750,000 death benefit. Penn-Mont made a settlement offer to Mrs. Castellano offering her the choice between: 1) \$75,000 per year for 10 years (without interest), or; 2) a lump sum of \$597,560.14.

Mrs. Castellano retained counsel. In November 2003, before making a formal denial of benefits, the REAL VEBA and Penn-mont filed this lawsuit, asking the court for a declaration that Mrs. Castellano was not entitled to the death benefit. Mrs. Castellano asserted counterclaims under ERISA and other applicable laws.

On June 7, 2005, Dr. Castellano's sons (heirs to the dental practice and stepsons hostile to Mrs. Castellano) settled other claims which the employer had against the REAL VEBA. As part of that settlement, it was agreed by the sons that the dental practice would end its participation in the REAL VEBA effective October 2003, after Mrs. Castellano filed her claim for benefits but before any benefit had been agreed to or paid to her by the plan.

On June 27, 2005, Penn-Mont issued a final determination denying Mrs. Castellano's claim based on the following:

- (1) the beneficiary designation form naming Mrs. Castellano was "questionable and possibly illegitimate,"
- (2) the employer had terminated its participation in the REAL VEBA, and no beneficiary is entitled to a benefit after termination of the plan by an employer,
- (3) Mrs. Castellano violated the "bad boy" clause in the plan by filing counter claims against REAL, and therefore was not entitled to a benefit and,
- (4) by hiring an attorney on a contingent fee, Mrs. Castellano "likely engaged" in a prohibited pledge or alienation of plan benefits.

The court quickly disposed of three out of the four reasons for denial of the benefit. With respect to item one, the court concluded that there was no evidence of fraud. With respect to item three, the court found that since the REAL VEBA had initiated the lawsuit, Mrs. Castellano had a right to respond. The court disposed of the fourth reason for denial, on the basis that it represents an overbroad reading of the anti-alienation provisions.

The court focused its discussion on the second reason for denial of benefits, that termination by the employer of participation in the REAL VEBA divested Mrs. Castellano of her right to plan benefits. With respect to this claim, the court found ambiguity in the plan documents. One section of the plan documents clearly stated that when the employer terminated its participation in the REAL VEBA, employees lost all rights to benefits "including without limitation, those benefits for which claims have been made but not yet paid."

But, a second provision provided rules for distributions to employees *after* the employer had ended its participation in the REAL VEBA. Distributions were to be made only from the remaining balance of the participant accounts attributable to the employees.

The court reasoned that, if the first section was taken literally, the second section would be meaningless—because there could never be a distribution to an employee after the employer ended participation in the REAL VEBA. The court concluded that this conflict gave rise to ambiguity.

Then the court focused on the specific facts. Mrs. Castellano timely filed her claim. The plan administrator sued her before making a final determination to deny benefits. Three of the four bases for denying the claim were meritless. The fourth was based on plan termination by an employer controlled by Mrs. Castellano's hostile stepson, three months after she had applied for benefits, and after the REAL VEBA had been paid by the life insurance carrier. Under these facts, the Court concluded, it was an abuse of discretion to construe the "ambiguous" plan documents against Mrs. Castellano.

Though the court acknowledged the "abuse of discretion" standard of review, the court appears to have stretched to find a basis to overturn the administrator's denial of benefits in this case. First the court noted that there was a conflict of interest that factored into the analysis of whether there had been an abuse of discretion by the Plan administrator. Secondly, the court clearly thought that three out of the four reasons articulated for denial were spurious. Finally, with respect to the remaining claim, the court stretched to find ambiguity in the plan documents because the court thought the denial of benefits under these facts to be clearly unfair. Therefore, the court granted summary judgment to Mrs. Castellano, ordering immediate payment of the \$750,000 death benefit.

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