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The firm is pleased to announce that Candice Kim passed the Oregon State Bar exam and will be sworn in in October. Candice joined the firm's estate planning group in January 2005. She is a graduate of Boston University School of Law and is also currently licensed to practice law in New York.

Parsons Farnell & Grein, LLP is a boutique firm specializing in helping Northwest businesses and their leaders. Our law practice concentrates on general business litigation, policyholder insurance disputes, construction litigation, business formation, business and real estate transactions, estate planning, probate, and tax planning/litigation.

**Bait and Switch: Insurers
Market ERISA Compliant
Fidelity Bonds, Then Honor
Only Partial Compliance**

*Michael Farnell & Emily Robertson,
Insurance Coverage Specialists*



Is your 401(k) plan (or a plan you administer, manage or direct) covered by a commercial crime policy (otherwise known as an employee fidelity bond) containing an endorsement entitled "Welfare and Pension Plan ERISA Compliance"? If so, it is quite likely that your bond purporting to achieve "ERISA compliance" will in fact be interpreted by the insurance industry to provide less than full compliance with ERISA.

ERISA, which stands for Employee Retirement Income Security Act, requires that certain employee benefit plans, such as pension, 401(k) and health and welfare plans, be

protected by insurance from loss caused by the fraud or dishonesty of any person, whether an employee or independent contractor, who is a plan fiduciary or otherwise handles* the plans' funds. An ERISA bond must provide coverage for at least 10% of the insured plan's handled assets, but in any event, is not required to provide more than a \$500,000 limit per insured plan. It is important to remember that when multiple plans are insured under the same bond, the limit must be sufficient to provide each covered plan its own requisite limit.

The insurance industry has interpreted the bond containing the "Welfare and Pension Plan ERISA Compliance" endorsement to provide only partial compliance with ERISA's bonding requirement. In response to claims made by plans, the industry asserts that this endorsement does not cover independent contractors. Under the insurers' view of the world, independent contractors must be covered under an agents rider, a separate endorsement that is rarely offered and difficult to obtain. Unfortunately, many brokers appear to believe that the "Welfare and Pension Plan ERISA Compliance" endorsement is sufficient and neither inquire about nor confirm the bonds' compliance with ERISA's coverage mandate. As a result, many insured plans do not realize that the ERISA compliance they believe they just secured will not be honored by their insurers. This is particularly troublesome given that most plans operate with heavy support from persons that insurers will deem independent contractors, such as administrators, consultants and investment managers.

In addition, the commercial crime policy accompanying the "Welfare and Pension Plan ERISA Compliance" endorsement usually contains a "manifest intent" condition to recovery. This condition requires that the dishonest actor have acted with the manifest intent to cause the plan loss and obtain financial benefit (other than employee benefits earned in the course of employment, such as salaries, commissions, fees, bonuses,

promotions, awards, profit sharing or pensions) for either him or herself or an intended third party. In contrast, ERISA requires coverage for loss caused by any fraud or dishonesty, without limitation, regardless of whether the dishonest actor receives any benefit at all. Under ERISA, any inquiry into who received how much of what benefit is immaterial. The focus should be on how much loss was caused by a fiduciary or handler's dishonesty. Accordingly, even if a plan obtains an agents rider, these commercial crime policies may still be interpreted by your insurer to provide only partial compliance with ERISA. The title of the "Welfare and Pension Plan ERISA Compliance" endorsement is entirely misleading in this respect.

If your plan's bond contains a "Welfare and Pension Plan ERISA Compliance" endorsement, consider consulting an insurance coverage specialist to ensure that your employee benefits (or those for which you have fiduciary obligations) are adequately protected as required by ERISA. Or, if your plan has recently sustained a loss caused by a fiduciary or handler's dishonesty, consider consulting an insurance coverage specialist to see if you might have a claim under the "Welfare and Pension Plan ERISA Compliance" endorsement, even if your insurer has denied your claim.

***Whether an individual is a "handler" is determined under regulations promulgated by Department of Labor. Suffice it to say, this regulatory definition of handling is very expansive.**

Buying a Business? Why Your Lawyer Should Draft the Purchase Documents

By Amy Larson



Many clients who are buying a business come to see us after the purchase documents have been drafted by the seller's attorney. This seems like an attractive bargain: the seller bears the legal fees for drafting the documents and the buyer bears only the cost of revisions. Seems like a cost-effective deal for the buyer, right? In many cases, it's not. Here's why.

The Drafter's Advantage. The drafter gets the first crack at defining the deal. Even if the major deal points have been negotiated beforehand, the drafter still gets the first, and best, opportunity to put in (or to leave out) all manner of provisions and clauses which can significantly reduce the value of the deal for the buyer. The seller will often try to shift the lion's share of the risk associated with the business to the buyer. Since the purchase documents are essentially the buyer's offer, the buyer, not the seller, should control the initial terms on which it proposes to buy the business. Furthermore, the buyer usually has more at stake because it does not know what hidden liabilities may be associated with the business and it does not have the same options for securing its risk as the seller. In a seller-financed deal, the seller can secure its risk of nonpayment by taking a security interest in the assets and requiring a personal guaranty. The buyer, on the other hand, is generally not afforded similar security in the event the seller does not fulfill its promises or misrepresents the condition or liabilities of the business. The buyer's sole protection lies in the strength of the seller's representations and indemnity obligations; therefore, these provisions should be carefully crafted to maximize the buyer's protection.

Revisions Can Be Costly. Many buyers mistakenly believe that it will be less expensive to pay their attorney to revise documents prepared by the seller than to have their attorney prepare the original documents. This may or may not be the case. The negotiations necessary to cure seller-bias in the original documents can be extensive or minimal, depending on the aggressiveness of the drafter. More often than not, turning biased documents into pro-buyer, or at least neutral, documents is more time-consuming and expensive than preparing buyer-friendly documents in the first place. Unless the parties have done deals together in the past (including the parties' attorneys), it is virtually impossible to identify up front whether it will be more cost-effective for the buyer for its attorney to draft the documents or the seller's attorney.

Bargaining Power. Even if the short-term cost can be accurately determined, the long-term cost of giving up negotiating leverage cannot. While every deal is unique, the final documents initiated by the seller are rarely as buyer-friendly as those which are initially drafted by the buyer's attorney. Once terms have been put in writing, the buyer is in the position of "asking" the seller for changes. This is a reactive position and an inherently weaker position, and the buyer often ends up making concessions that it would not have made had it drafted the documents. For example, seller-drafted documents frequently contain minimal representations and warranties. The seller's representations and warranties are critical to the buyer's ability to recover from the seller for the seller's misrepresentations or bad acts. The stronger the representations, the more protection the buyer has in the event it suffers liability arising from the seller's acts or misrepresentations. It is critical that the seller's representations and warranties be carefully crafted to provide the buyer as much protection as possible. If the seller's documents give only three or four representations (as is often the case), it can be difficult to convince the seller to later give additional representations. Asking for these additional representations, even standard ones which arguably should have been included in the original draft, can seem unreasonable and serve to irritate the seller, thereby making the seller less agreeable to other changes which may be desirable.

While the seller's offer to draft the documents may be tempting, keep in mind why the seller is offering to draft the documents. It is for the same reason the buyer should want to draft the documents - to define the terms of the deal up front. In many cases, the seller has used the documents before and has them crafted to its advantage. Negotiating buyer-friendly terms into pro-seller documents can be an uphill battle and one that we recommend that buyers avoid from the outset. While you may or may not save money in the short run, the cost of weakening your bargaining position is immeasurable.

Complying With the Fair Credit Reporting Act - What Employers Need to Know

By *Samantha Mender*



Given the potential economic and legal consequences that may be faced by an employer who hires an employee with an undesirable background, many employers are opting to conduct background investigations as part of the employment application process. Background investigations can provide extensive information about a prospective employee, including criminal and civil records, driving records, educational records and reference checks. While such investigations are useful, employers must take care to comply with the Fair Credit Reporting Act (FCRA).

Although the FCRA is a consumer protection statute, both job applicants and employees are consumers whose rights are protected under the FCRA. Under the FCRA, it is permissible for an employer to obtain a background report (a “consumer report”) to use for employment purposes. Whenever an employer obtains information about a prospective or current employee from an agency (a “consumer reporting agency”), it must comply with the FCRA, which lays out the requirements and rules for obtaining and using consumer reports. Bear in mind that the definition of “consumer reporting agency” is very broad, and could include internet search services that assemble publicly available information for their on-line customers.

In order to obtain a consumer report about a prospective employee from a consumer reporting agency, employers need to follow a number of steps.

First, prior to obtaining a consumer report, the employer must certify to the consumer reporting agency that the employer: (1) will only use the information for employment purposes; (2) will not use the information obtained for an illegal purpose; (3) will provide all necessary disclosures and obtain all necessary consents; (4) will give appropriate notices in the event that information in the report leads, in whole or in part, to an adverse action; and

(5) will give additional required information to the prospective employee if a special report, called an investigative consumer report, is requested.

Second, and also prior to obtaining a consumer report, the employer must provide a disclosure to and obtain a release from the prospective employee. The disclosure must be a separate document from the employment application and must clearly and conspicuously inform the prospective employee that a consumer report may be obtained. The employer must obtain the prospective employee’s written consent. The consent and disclosure can be on the same form, as long as the disclosure is clear and conspicuous. When an investigative consumer report is requested there are additional procedures that must be followed. The employer must: (1) disclose that an investigative consumer report is being requested; and (2) tell the prospective or current employee that they have the right to request additional information about the nature of the investigation. If information is requested, the employer must respond in writing and provide a copy of a document (available from the Federal Trade Commission) entitled “A Summary of Your Rights Under the Fair Credit Reporting Act”. This must be provided within 5 days of the request, or within 5 days of ordering the report, whichever is later.

Third, if the employer intends to take any adverse action as a result of the contents of the consumer report, then prior to taking any adverse action the employer must provide a “pre-adverse action” notification and provide the prospective employee with a copy of the consumer report and a copy of “A Summary of Your Rights Under the Fair Credit Reporting Act”. The prospective employee therefore has an opportunity to contact the consumer reporting agency if there are inaccuracies or omissions in the report. Even if the consumer report is only one of several factors involved in making an adverse decision, these items must be provided. (Even if the employer’s decision is not based on the report at all, it might be wise to provide these documents anyway). Although the FCRA does not specify an amount of time that an employer should wait after

providing these documents and before making a final decision, the time allotted should be reasonable enough to allow the prospective employee to review the report and address any inaccuracies or omissions with the consumer reporting agency that provided the report.

Finally, if a final decision is then made to take an adverse action against the prospective employee, the employer must provide additional notice after the adverse action is taken. This must inform the prospective employee of the action taken or decision made as a result, in whole or in part, of the consumer report. The notice must include the name, address, and telephone number of the agency that provided the report, explain that the agency did not make the decision and cannot explain why it was taken, and inform the prospective employee of his or her right to obtain a copy of the report and to dispute its accuracy. Another copy of the Federal Trade Commission’s publication entitled “Summary of Your Rights Under the Fair Credit Reporting Act” should be provided.

While the second notice may seem like overkill, the FCRA clearly requires both notices. Failure to comply with the FCRA can have serious consequences, including compensatory and punitive damage awards and attorney fees. Employers should take the time to understand the FCRA and develop a compliance plan. Employers should also confirm that any reporting agency they decide to use is in compliance with the FCRA.