

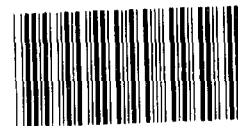
BY THE U.S. GENERAL ACCOUNTING OFFICE

Report To The Chairman,
Committee On Labor And Human Resources
United States Senate

The Department Of Labor's Handling Of The
Investigation And Litigation Of Alleged
Abuses Of The Southern Nevada Culinary
Workers And Bartenders Pension Trust Fund

The Department of Labor's investigation and litigation of alleged abuses of the Southern Nevada Culinary Workers and Bartenders Pension Trust Fund (the Trust) resulted in one of the major suits brought to date under the Employee Retirement Income Security Act (ERISA) of 1974. ERISA was the first comprehensive legislation passed regulating private pension plans. Under its ERISA responsibilities, Labor investigated certain allegations made against the Trust, substantiated the alleged problems, and initiated civil litigation against the Trust trustees and others.

This report responds to questions raised by the Chairman regarding Labor's handling of the investigation and litigation of the alleged abuses of the Trust.



125540

530226

GAO/HRD-84-60
SEPTEMBER 28, 1984

Request for copies of GAO reports should be sent to:

U.S. General Accounting Office
Document Handling and Information
Services Facility
P.O. Box 6015
Gaithersburg, Md. 20760

Telephone (202) 275-6241

The first five copies of individual reports are free of charge. Additional copies of bound audit reports are \$3.25 each. Additional copies of unbound report (i.e., letter reports) and most other publications are \$1.00 each. There will be a 25% discount on all orders for 100 or more copies mailed to a single address. Sales orders must be prepaid on a cash, check, or money order basis. Check should be made out to the "Superintendent of Documents".



UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548

HUMAN RESOURCES
DIVISION

B-216459

The Honorable Orrin G. Hatch
Chairman, Committee on Labor
and Human Resources
United States Senate

Dear Mr. Chairman:

In response to your request letter and subsequent meetings with your office, we have examined the Department of Labor's handling of the investigation and litigation of alleged abuses of the Southern Nevada Culinary Workers and Bartenders Pension Trust Fund (the Trust). Labor's investigation of the Trust resulted in one of the major suits brought to date under the Employee Retirement Income Security Act (ERISA) of 1974, as amended (29 U.S.C. 1001, *et seq.*). ERISA was the first comprehensive legislation passed regulating private pension plans. Labor is responsible for enforcing the act's reporting, disclosure, and fiduciary provisions.

We made our review at Labor headquarters in Washington, D.C., and at Labor's San Francisco and Los Angeles offices. We reviewed the pertinent provisions of ERISA and Labor's regulations, policies, and strategies for enforcing ERISA, investigating funds, and litigating civil cases. We reviewed and evaluated documents compiled by Labor during its investigation and litigation. We also interviewed former and present Labor officials regarding the department's handling of the case. The details of the case discussed in this report are a matter of public record.

Our findings and conclusions are summarized below and discussed in greater depth in the appendixes. The details of the scope and methodology, including the specific matters you asked us to review, are discussed in appendix II. The list of agency officials responsible for the activities discussed in this report is in appendix VIII.

BACKGROUND

Between 1973 and 1977, trustees of the Trust loaned \$24.9 million to corporations controlled by Mr. Morris Shenker, owner, at that time, of the Dunes Hotel and Casino in Las Vegas, Nevada. None of these loans were fully repaid. According to the Trust's current real estate asset manager (a representative of a trust who acquires, manages, and/or disposes of a trust's assets), the amount due to the Trust in August 1983, including principal and interest, was about \$36.7 million. This figure takes into account real estate pledged to the Trust as collateral valued by the Trust's asset manager at about \$13.4 million.

Under its ERISA responsibilities, Labor investigated certain allegations made against the Trust. After substantiating the alleged problems, Labor filed a complaint--the initial document filed with the court which describes the allegations--initiating civil litigation against the Trust's trustees, Mr. Shenker, and four companies owned or controlled by Mr. Shenker--Murrieta Hot Springs (Murrieta), Sierra Charter Corporation (Sierra), IJK Nevada, Inc. (IJK), and S&F Corporation (S&F). Murrieta, Sierra, and S&F are real estate development companies. IJK is a holding company originally formed to hold stock of the Dunes. Labor's complaint, dated March 30, 1977, alleged that the defendant trustees (1) breached their fiduciary responsibility, (2) failed to diversify Trust assets as required by ERISA, and (3) made illegal loans to parties related to employers contributing to the Trust (parties in interest). Labor also alleged that Mr. Shenker controlled all of the previously named corporations and, as a shareholder and an officer of an employer who made contributions to the Trust through the Dunes, was therefore a party in interest. Labor sought restitution to the Trust from all the defendants for all moneys allegedly loaned, including interest, and from the defendant trustees for losses incurred as a result of their alleged fiduciary breaches. In February 1980, the Trust asset manager, T. L. Karsten, Associates (Karsten), also filed a complaint against Mr. Shenker, Sierra, and IJK seeking restitution to the Trust. In 1978 and 1979, the trustees filed suits against the Trust attorneys for malpractice.

In January 1983, Labor settled with all of the defendant trustees (except one) for \$3.7 million. The Trust attorneys, although not named in the complaint, were included in this settlement. Through an informal agreement, the malpractice

claims filed against the attorneys by the trustees were dropped. In April 1984, the remaining trustee was enjoined from serving as a trustee of an ERISA-covered plan for 5 years.

Both Labor's and the asset manager's cases against Mr. Shenker and his companies went to trial in U.S. district court on June 1, 1983. Karsten's claims were based on contract and such other common law theories as fraud. Labor's claims, in contrast, were based on ERISA violations. Because the legal character of the asset manager's claims entitled the defendants to a jury trial, both cases were heard by the jury.

On November 28 and 30, 1983, the jury decided on the asset manager's claims and found Mr. Shenker liable for the loans. The asset manager was seeking \$36.7 million plus the collateral properties. Based on the jury's verdict, the court ordered Mr. Shenker to pay the Trust \$33.9 million and allowed the Trust to retain the properties. On January 3, 1984, Mr. Shenker filed a bankruptcy petition. According to a Labor official and statements Mr. Shenker made to the press, the filing was specifically aimed at blocking attachment of his assets under the November judgment, pending the estimated 1 to 2 years he expects to be involved in his appeal. The petition listed 49 creditors' claims totaling about \$184 million.

The court ruled on Labor's claim on May 15, 1984, confirming the Karsten judgment of \$33.9 million. The court ordered Mr. Shenker to pay \$33.9 million in restitution to the Trust, awarded interest on that figure to May 15, 1984, and allowed the Trust to retain the properties. The court also awarded costs and attorneys fees. This amount has not yet been determined. In addition, the court plans to decide on the amount of post-transfer property expenses to be assessed to Mr. Shenker. Post-transfer expenses are the costs incurred by the Trust after the ownership of the collateral property was transferred to it. In June 1984, the case supervisory attorney told us that Mr. Shenker's bankruptcy would continue to delay collection of the judgment.

LABOR HAD EARLY INDICATIONS OF PROBLEMS BUT DID NOT PROMPTLY INVESTIGATE THE FUND

Although Labor had indications of problems with the Trust's financial management in 1975, it did not begin an onsite investigation of the Trust until March 1977.

In September 1975, Labor obtained information questioning the Trust's loans to two Shenker-controlled corporations (Murrieta and Sierra). This information, documented in a September 1975 Department of Labor memorandum, included an allegation that the Trust had made \$7 million in illegal loans under ERISA to Mr. Shenker. At this time, Labor also knew that Mr. Shenker had received \$57 million in alleged illegal and imprudent loans from two other pension funds and that he had connections with alleged organized crime figures. Between September 1975, when Labor first learned of the Shenker loans, and March 1977, when Labor filed its complaint, the Trust disbursed \$10.1 million in loans to Shenker-controlled corporations.

None of the Labor headquarters or field officials that we talked with could recall the September 1975 memorandum or recall specifically why investigative action was not taken earlier. They told us that Labor did not have ERISA enforcement procedures in 1975 and that much of their staff's time was spent on technical assistance work--answering questions about the newly enacted (1974) statute--and not on enforcement activities. An assistant regional administrator told us that in September 1975, ERISA investigators did not have a high level of ERISA expertise and few investigations were started during this period. However, a division chief told us that an investigation should have been started given what Labor knew about Mr. Shenker and the other Shenker transactions.

THE SOLICITOR'S OFFICE ROLE IN
THE SELECTION OF THE TRUST'S
TWO ASSET MANAGERS

Labor does not have departmental policy or guidance regarding its role in the search for and selection of asset managers. Labor's role in the selection of the Trust's two asset managers was largely determined on an "ad hoc" basis by Solicitor's Office attorneys. Attorneys from the Solicitor's Office participated in the search for the first asset manager, Upper Avenue Bank (UAB), but did not participate in the selection of the second, and current, asset manager, Karsten.

LABOR'S ROLE IN MONITORING
THE TRUST'S ASSET MANAGER

Labor requested and obtained from the court a provision that required the asset manager to periodically report Trust investment activities and real estate transactions. Labor, however, did not develop a plan to receive, evaluate, and if necessary, act on the information it received. Consequently, the

Labor officials who performed some monitoring activities had such disagreements as (1) which Labor office should perform the monitoring, (2) how it should be accomplished, and (3) what action Labor should take regarding potentially imprudent investments.

The former asset manager, UAB, made two real estate investments in Trust collateral which caused some Labor officials to become concerned about the collateral's security. However, because of disagreements among the Labor offices and the lack of a monitoring plan, the department did not fully examine these transactions. The transactions took place and, according to a May 1981 assessment by Karsten of the Trust's real estate assets, one \$3.6 million transaction could result in a net loss of \$309,500.

CONCLUSIONS

Our review showed that, although Labor had indications of problems with the Trust's finances in 1975, it did not begin an onsite investigation until March 1977. During this period, the Trust disbursed \$10.1 million to the Shenker-controlled companies. We believe that, given what Labor knew about Mr. Shenker and his \$57 million in alleged illegal and imprudent loans from two other pension funds, an investigation should have been started earlier by Labor.

Our review also showed that Labor does not have formal policies and procedures regarding what role it should play in the search for and selection of trust asset managers. Our review, however, was limited to one fund, and we do not know if this lack of formal policy is a problem. In addition, Labor did not establish procedures to provide a planned and coordinated effort to monitor the Trust's asset manager's activities. Again, because our review was limited to one fund, we do not know how widespread or significant this problem may be.

- - - -

As agreed with your office, we did not obtain agency comments on this report. However, we discussed the matters contained in the report with Labor officials and considered their comments in finalizing the report.

Also, as agreed with your office, unless you publicly announce its contents earlier, we plan no further distribution of the report until 30 days from its issue date. At that time, we will send copies to the Secretary of Labor, other interested parties, and others upon request.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Richard L. Fogel". The signature is fluid and cursive, with a large initial "R" and "F".

Richard L. Fogel
Director

C o n t e n t s

	<u>Page</u>	
APPENDIX		
I	INTRODUCTION AND BACKGROUND	1
	The Employee Retirement Income Security Act	1
	ERISA enforcement	2
	The Trust	3
	Trust real estate investments	4
	Trust litigation	5
	Calculations of balance due to the Trust	6
II	OBJECTIVES, SCOPE, AND METHODOLOGY	8
III	LABOR HAD EARLY INDICATIONS OF PROBLEMS BUT DID NOT PROMPTLY INVESTIGATE THE TRUST	11
	Labor did not act on early information	11
	Labor stopped Trust disbursements on March 30, 1977	15
	Conclusions	17
IV	THE SOLICITOR'S OFFICE ROLE IN THE SELECTION OF THE TRUST'S TWO ASSET MANAGERS	18
	The search for the Trust's first asset manager	18
	The search for the second asset manager	19
	Conclusions	20
V	LABOR'S ROLE IN MONITORING THE TRUST'S ASSET MANAGER	21
	UAB was required to report certain transactions	21
	Labor identified problems with the Trust's real estate transactions	22
	GAO inquiries did not prompt PWBP or the Solicitor's Office to monitor the asset manager, Karsten	24
	Conclusions	25
VI	EFFORTS BY LABOR TO SETTLE WITH THE DEFENDANTS	26
	Settlement discussions with Mr. Shenker	26
	Settlement discussions with the trustees and Trust attorneys	26

APPENDIX

VII	ORGANIZATION CHART OF PRINCIPAL DEPARTMENT OF LABOR OFFICES INVOLVED IN THE ACTIVITIES DISCUSSED IN THIS REPORT	28
VIII	PRINCIPAL DEPARTMENT OF LABOR OFFICIALS RESPONSIBLE FOR THE ACTIVITIES DISCUSSED IN THIS REPORT	29

ABBREVIATIONS

CPA	Certified Public Accountant
ERISA	Employee Retirement Income Security Act
GAO	General Accounting Office
IRS	Internal Revenue Service
LMSA	Labor-Management Services Administration
PWBP	Pension and Welfare Benefit Program
UAB	Upper Avenue Bank

INTRODUCTION AND BACKGROUND

The Department of Labor's investigation and litigation of alleged abuses of the Southern Nevada Culinary Workers and Bartenders Pension Trust Fund (the Trust) resulted in one of the major suits brought to date under the Employee Retirement Income Security Act (ERISA) of 1974, as amended (29 U.S.C. 1001, et seq.). ERISA was the first comprehensive legislation passed regulating private pension plans. Labor is responsible for enforcing the act's reporting, disclosure, and fiduciary provisions.

Between 1973 and 1977, trustees of the Trust loaned \$24.9 million to corporations controlled by Mr. Morris Shenker, owner, at that time, of the Dunes Hotel and Casino in Las Vegas, Nevada. None of these loans were fully repaid. Under its ERISA responsibilities, Labor investigated certain allegations made against the Trust, substantiated the alleged problems, and initiated civil litigation against the Trust trustees, Mr. Shenker, and four companies owned or controlled by Mr. Shenker--Murrieta Hot Springs (Murrieta), Sierra Charter Corporation (Sierra), IJK Nevada, Inc. (IJK), and S&F Corporation (S&F). Murrieta, Sierra, and S&F are real estate development companies. IJK is a holding company originally formed to hold stock of the Dunes. Labor's litigation alleges that the Trust trustees and others violated the fiduciary responsibility, prohibited transactions, and investment diversification provisions of ERISA in the negotiation and management of a series of real estate loans.

THE EMPLOYEE RETIREMENT
INCOME SECURITY ACT

To protect employees' interests, ERISA established comprehensive minimum standards for how employees become eligible to participate in pension plans (participation standards), how employees earn a nonforfeitable right to pension benefits (vesting standards), how the plans should be funded (funding provisions), how the plans should be operated in the best interests of plan participants (fiduciary standards), and to what extent and to whom plan information is to be reported and disclosed (reporting and disclosure requirements). Labor and the Internal Revenue Service (IRS) share enforcement responsibilities for these standards. Labor is primarily responsible for enforcing the reporting, disclosure, and fiduciary provisions. IRS enforces the act's participation, vesting, and funding provisions.

One of the most important and significant features of ERISA, designed to prevent abuse and misuse of private pension funds, is the stringent requirements placed on persons acting as fiduciaries (persons who exercise discretionary control or authority by making decisions about a fund's management and assets). ERISA requires a fiduciary, such as a trustee or asset manager, to discharge his or her duties solely in the interest of the participants and beneficiaries for exclusively providing them with benefits and defraying the reasonable expenses of administering the fund. Fiduciaries are subject to the "prudent man rule." That is, they must exercise the care, skill, prudence, and diligence under the prevailing circumstances that a prudent person acting in a like capacity and familiar with such matters would use in conducting a similar enterprise. ERISA also requires fiduciaries to diversify fund investments so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so.

ERISA provides that fiduciaries who breach their responsibilities, obligations, or duties (1) shall be personally liable to make good any losses resulting from their actions and subject to removal and (2) may be subject to civil and criminal prosecution.

ERISA ENFORCEMENT

Within Labor, the Pension and Welfare Benefit Program (PWBP) office, formerly in the Labor-Management Services Administration (LMSA), enforces ERISA. LMSA is under the Assistant Secretary of Labor Management Relations. On January 20, 1984, the Secretary of Labor signed an order removing PWBP from LMSA and making it a separate unit in Labor, reporting directly to the Secretary. The transfer took effect on May 20, 1984.

PWBP performs its enforcement work through a staff at headquarters and in 6 regional and 24 area offices nationwide. PWBP provides program guidance and direction to regional and area office staff. Each regional office, under a regional administrator, is responsible for assuring effective operations and adherence to PWBP policy directives. Each regional office has an assistant regional administrator, who serves as a program expert and provides technical guidance and staff assistance to the regional administrator and the area office in the administration and enforcement of ERISA.

The area offices have primary responsibility for enforcing ERISA and are organized in groups that are responsible for investigating possible ERISA violations. Each area office generally consists of one or two group supervisors and 2 to 16 investigators.

The area offices initiate and conduct investigations concerning alleged ERISA violations. After an investigation, an area office may close a case if no violation is detected. If violations are found, the area office submits its investigative report to the regional office for review. The regional office reviews the case and returns it to the area office with recommendations to secure voluntary compliance, if appropriate. Under certain conditions, PWBP's approval must be obtained before attempting voluntary compliance. In cases where litigation is anticipated, the area office forwards the case to the regional office which forwards the case to PWBP. PWBP refers the case to the Office of the Solicitor, if appropriate. In most cases, PWBP is assisted by the Division of Plan Benefits Security in Labor's Solicitor's Office. In selected, complex cases PWBP is assisted by the Special Litigation Division within the Solicitor's Office.

THE TRUST

In December 1971, the Nevada Resort Association, the Culinary Workers union Local 226, and the Bartenders union Local 165 entered into a trust agreement creating the Nevada Resort Association-Culinary Workers and Bartenders Pension Trust Fund. These unions are affiliated with the Hotel and Restaurant Employees International Union.

The Trust was organized as a multiemployer plan under the Labor Management Relations Act of 1947, as amended, commonly called the Taft Hartley Act (29 U.S.C. 186 (c)(5)), for the exclusive purpose of providing pension benefits for employees who were members covered by collective bargaining agreements between the two unions and the employers. This act provides that such funds based on payments or contributions from employers be (1) managed for the sole benefit of eligible employees and their beneficiaries, (2) governed by a written agreement specifying the employer payments and contributions and employee benefits, and (3) administered by an equal number of representatives from employees' and employers' organizations. In November 1973, the Trust trustees changed the Trust's name to the Southern Nevada Culinary and Bartenders Pension Trust.

The Trust, from its inception in 1971, has been administered by a board of six trustees, three representing the employers and three representing the unions. Under the Trust agreement, the trustees had exclusive management and control of the Trust, including asset investment decisions. An administrator manages the day-to-day activities of the Trust, and a controller is the Trust's chief accounting officer. There are currently about 37,000 participants in the Trust.

TRUST REAL ESTATE INVESTMENTS

Between 1973 and 1977 the Trust loaned Murrieta and Sierra \$24,930,000. The loans are summarized below.

Funds Loaned to Shenker-Controlled Corporations

<u>Date</u>	<u>Borrower</u>	<u>Amount</u>
Mar. 24, 1973	Murrieta Hot Springs	\$ 2,000,000
July 30, 1973	Murrieta Hot Springs	5,000,000
June 7, 1974	Sierra Charter	7,450,000
July 28, 1975	Sierra Charter	1,350,000
Dec. 1, 1975	Sierra Charter	<u>9,130,000</u>
Total		<u>\$24,930,000</u>

In addition to these loans, in May 1976, the Trust also guaranteed to Valley Bank of Nevada a \$2,450,000 Sierra loan. According to Labor, the \$24.9 million in loans represented 53 percent of the Trust's assets at December 31, 1977.

The March 1973 loan was secured by 206 lots at the Murrieta Hot Springs development in California. In July 1973, the trustees agreed to loan Murrieta an additional \$5 million. This loan was secured by 556 acres of undeveloped land in the Murrieta development.

The June 1974 loan to Sierra was secured by a trust deed on tracts of land located at Gardnerville, Nevada. Under the July 1975 agreement the trustees lent Sierra an additional \$1,350,000. This loan, which was an addendum to the original Sierra loan, also obligated Sierra to assume payment of interest due from Murrieta on the original \$2 million loan. Sierra assigned its equity in certain third-party lot sale contracts to the Trust as security for this loan.

Under the December 1975 commitment, which also was an addendum to the original loan, the Trust advanced Sierra an additional \$9,130,000. The monthly advances averaged about \$570,000 per month from December 1975 through March 1977. Sierra also agreed to guarantee all of Murrieta's indebtedness to the Trust, including interest then due from Murrieta and Sierra. Repayment of moneys loaned under the first and second addenda and the 1974 loan to Sierra were also personally guaranteed by Mr. Shenker. These amounts were to be added to the total principal and interest due and bear interest at 11 percent per year. Deeds from the sales of lots at the Murrieta and Sierra developments were assigned to the Trust as additional collateral.

TRUST LITIGATION

On March 30, 1977, Labor filed an ERISA civil suit in the district court, District of Nevada, against present and past trustees; Mr. Morris A. Shenker; and Shenker-controlled corporations (IJK, Murrieta, S&F, and Sierra). Labor alleged that the defendant trustees (1) breached their fiduciary responsibility, (2) failed to diversify fund assets, and (3) made illegal loans to parties related to employers contributing to the Trust (parties in interest). Murrieta and Sierra were the loan recipients, IJK and S&F received loaned funds through Sierra, and IJK indirectly employed persons who were participants in and covered by the Trust. Labor alleged that Mr. Shenker controlled all of the previously named corporations and, as a shareholder and an officer of an employer who made contributions to the Trust through the Dunes, was therefore a party in interest. In a December 1982 amended complaint, Labor alleged that Mr. Shenker, IJK, Murrieta, Sierra, and S&F knowingly participated in these ERISA violations. Labor sought restitution to the Trust from all the defendants for all moneys advanced, including interest. Labor believed that all of the loans were covered by ERISA, including the pre-ERISA loans, because addenda made to these loans after the effective date of ERISA constituted material changes.

Sierra and Mr. Shenker filed counterclaims against Labor claiming damages for its allegedly negligent investigation, unwarranted institution of litigation, failure to discuss settlement, fiduciary breaches, and pursuit of a "vendetta" against Mr. Shenker.

In February 1980, the Trust's asset manager at that time, T. L. Karsten, Associates (Karsten), filed suit against Mr. Shenker, Sierra, and IJK charging Mr. Shenker and Sierra with fraud and seeking restitution to the Trust. Mr. Shenker and

Sierra, in turn, filed counterclaims against the Trust's asset manager, Karsten. Mr. Shenker and Sierra also sued the former asset manager, Upper Avenue Bank (UAB), now Lakeshore Bank of Chicago. Both asset managers were sued by Sierra for alleged failure to preserve the value of the collateral properties.

From March 1977 to May 1982 the Trust's litigation was handled by Labor's Division of Plan Benefits Security. In May 1982, Labor moved the case to the Special Litigation Division to better concentrate its resources and efforts on what it considered a large and complex litigation.

The jury ruled on Karsten's claims in November 1983, and the court ruled on Labor's claims in May 1984. All other litigation filed during this case has been dismissed by the court or settled.

CALCULATIONS OF BALANCE DUE TO THE TRUST

In August 1983, at Mr. Shenker's trial the Trust asset manager set the amount due (minus the collateral) on the Murrieta and Sierra loans at \$34,797,525.

Balance Due to Trust on Murrieta and Sierra Loans At August 1, 1983

	<u>Murrieta</u>		<u>Sierra loans</u>	<u>Total</u>
	<u>\$2 million loan</u>	<u>\$5 million loan</u>		
Loan advances	\$2,000,000	\$5,000,000	\$17,930,000	24,930,000
Accrued interest	1,936,020	4,609,289	19,935,015	26,480,324
Borrower payments on the loans	(336,521)	(691,913)	(444,117)	(1,472,551)
Credits from lot sales of collateral	(174,621)		(1,500,857)	(1,675,478)
Collateral prop- erty values ^a	<u>(1,296,096)</u>	<u>(5,086,980)</u>	<u>(7,081,694)</u>	<u>13,464,770)</u>
Balance due	<u>\$2,128,782</u>	<u>\$3,830,396</u>	<u>\$28,838,347</u>	<u>34,797,525</u>

^aThe court established a valuation date for each property, either the date the property was sold or the date the title was transferred to the Trust, whichever was earlier. The asset manager determined the property values as sales prices or appraisal values, minus expenses and liens against the properties, as of the court established date.

The balance due at August 1, 1983, does not include the amount due on the Valley Bank of Nevada loan. The Trust settled its liability under this guarantee by paying \$1,951,445 to the Valley Bank. Therefore, for litigation purposes, the Trust asset manager included this loan and set the total balance due to the Trust on August 1, 1983, at \$36,748,970.

Labor's calculation for litigation purposes is different from the asset manager's figure. Labor calculated the amount due to the Trust as of November 1, 1983, at approximately \$61,000,000. According to the supervisory attorney handling the litigation, Labor's figure is higher because they (1) included additional interest accrued on the loans from August 1, 1983, to November 1, 1983, (2) included only cash expenses paid on the collateral properties before and after the valuation dates, (3) included payments received from the sale of collateral properties, and (4) gave no credit for the collateral properties still held by the Trust because they believed that the defense did not prove the values in court. If credit for the collateral properties is given, the amount due to the Trust, according to Labor, is approximately \$50 million.

OBJECTIVES, SCOPE, AND METHODOLOGY

The Chairman's request asked us to review how the Department of Labor conducted its investigation and litigation of allegations of abuse of the Trust. Specifically, the Chairman asked us to answer the following questions:

- When did Labor first discover that the Trust had loaned out at least \$23 million of its assets?
- How much money did the Trust loan for real estate investment?
- How were these loans secured? What collateral was provided?
- Who were the loans made to?
- What attempts has Labor made to retrieve the money?
- What is the amount of the current indebtedness?
- Have the trustees been replaced to protect the Trust's membership?
- Did Labor select the Trust asset manager or advise the court on the appointment of the Trust asset manager?
- Who is the current Trust asset manager and how was this asset manager selected?
- What are Labor's policies regarding the selection of asset managers?
- What is the current status of the case?
- What offers to settle, if any, have been made by Labor?
- Was an analysis of the Trust's real estate investments made by Labor? If so, what were the findings? What actions were taken?
- Do we believe that Labor handled this case in a prompt, efficient manner that safeguarded the union membership and its assets?

--What recommendations, if any, do we have?

--Which Labor officials have been responsible for the handling of the case?

It is GAO's policy not to interfere with issues before the courts. Therefore, we do not express an opinion on the merits of Labor's litigation or on Labor's handling of the trial.

We made the review at Labor's headquarters in Washington, D.C., and at its regional and area offices in San Francisco and Los Angeles, respectively.

Our review was performed in accordance with generally accepted government auditing standards.

At Labor's headquarters, we reviewed the pertinent provisions of ERISA, particularly those relating to Labor's enforcement and litigation authority and responsibilities. In addition, we identified and evaluated Labor regulations, policies, procedures, and strategies for enforcing ERISA and for investigating pension plans and litigating civil cases.

Our review of Labor's activities regarding the Trust's case was based primarily on an extensive review and evaluation of the voluminous records and documents compiled (more than 700,000 documents were gathered before the trial) by Labor. These documents included depositions (testimony taken down in writing under oath), deposition exhibits (documents produced and identified during a deposition for use as evidence), and pleadings (formal written allegations and counter allegations made by the parties in a legal action).

At Labor's Office of the Solicitor, which is litigating the Trust's case, we reviewed (1) approximately 2,000 deposition exhibits which were available as of November 1982 and selected deposition exhibits available after November 1982, (2) selected depositions (472 depositions were taken during the litigation), (3) about 1,000 pleadings which had been filed by November 1982 and selected pleadings filed after November 1982 (2,154 pleadings had been filed as of April 1984), and (4) all case management and correspondence files. Labor gave us access to all of its documents and files, including Solicitor's Office case management files.

We interviewed most former and present management, supervisory, and line attorneys who worked on the litigation, including a former Solicitor, the Deputy Solicitor, and other Solicitor's Office staff who worked on the case, such as accountants and technical staff.

Within Labor, PWBP enforces ERISA. PWBP and area staff performed the investigation of the Trust. At Labor's headquarters, we reviewed PWBP's strategy, policies, and procedures for carrying out its enforcement responsibilities and achieving compliance under ERISA. We discussed enforcement strategy and the investigation and litigation of the Trust's case with current and former PWBP officials and staff, including the former administrator of PWBP and the former assistant administrators of the Offices of Enforcement and of Fiduciary Standards. We reviewed all documents regarding the case that were available in the PWBP office. These documents included the Trust's investigative files, files regarding the Trust's requests to obtain Labor's permission to engage in real estate transactions normally prohibited under ERISA, and files on the severance pay and health and welfare funds. Our review was limited to Labor's investigation of the Trust, and we did not review Labor's current ERISA enforcement activities.

We interviewed the assistant administrator for Field Operations and Labor officials in the Los Angeles and San Francisco offices, and we reviewed Labor's case files on the Trust in Los Angeles and San Francisco. We also conducted telephone interviews with staff in Labor's St. Louis area office in its Kansas City region. This office had investigated loans that Mr. Shenker's companies had received from another union's pension fund.

During our review, we also examined hundreds of documents regarding the Trust that the Committee staff had given us, most of which we had already received from Labor. We also obtained the staff's analyses of the documents. We discussed the case with Committee staff who had been investigating Labor's activities in preparation for Committee hearings.¹

¹Oversight Hearings on the Culinary Workers Pension Trust Fund, February 1982, Senate Committee on Labor and Human Resources.

LABOR HAD EARLY INDICATIONS OF PROBLEMSBUT DID NOT PROMPTLY INVESTIGATE THE TRUST

Labor had information in September 1975 questioning the Trust's financial management, including an allegation that the Trust had made \$7 million in prohibited loans to Shenker-controlled companies. Similar allegations continued through 1976. Labor also received allegations that Mr. Shenker obtained an additional \$57 million in alleged illegal and imprudent loans from two other pension funds. In addition, Labor knew that, according to the Department of Justice, Mr. Shenker had connections with alleged organized crime figures.

Although Labor had early indications of problems, it did not begin an onsite investigation at the Trust until March 1977. Within 3 weeks of the start of the investigation, Labor filed a civil lawsuit that stopped the Trust's average monthly disbursements of \$570,000, from the December 1975 loan to the Shenker-controlled corporations. Between September 1975, when Labor first learned of the Shenker loans, and March 1977, when the complaint was filed, the Trust disbursed \$10.1 million of the total \$24.9 million to Shenker-controlled companies.

LABOR DID NOT ACT ON
EARLY INFORMATION

According to the former assistant administrator of the Office of Enforcement, Labor was aware, prior to 1970, of allegations about Mr. Shenker's relationships with alleged organized crime members and knew that the Justice Department had investigated him regarding his receipt of fees for securing loans for third parties from the Teamster's Central States, Southeast and Southwest Areas Pension Fund (Teamsters). By late 1975 Labor had allegations of illegal loans to Shenker-controlled corporations from the St. Louis Pipefitters Pension and Welfare Funds, Teamsters, and the Culinary Workers Pension Trust. These loans totaled about \$57 million.

Labor did not act on an early lead

On September 25, 1975, Labor's St. Louis area office administrator sent a memorandum and newspaper article to the branch chief, Special Investigations, Labor Management Standards Enforcement (the LMSA unit responsible for regulating labor unions). The memorandum provided information on two Trust loans

to Murrieta. The newspaper article alleged that Mr. Shenker had borrowed \$12 million, secured by the Murrieta property, from the Pipefitters union Local 562 pension and welfare funds and that the Pipefitters pension fund had taken ownership of some of the property because Murrieta was delinquent on its payments. The memorandum also described allegations that two Trust trustees representing the employers had resigned because they opposed the loans. The St. Louis area office had obtained this information while investigating a Hotel, Motel, Restaurant, Food Service and Bartenders local union in St. Louis, Missouri.

Copies of the memorandum were sent to PWBP's Branch of Fiduciary Standards and Investigations, the Kansas City and San Francisco regional offices, and the Los Angeles area office. The memorandum was sent to Kansas City because the St. Louis area office is located in that region. Subsequently, according to the San Francisco assistant regional administrator, the chief of Special Investigations forwarded the memorandum to the San Francisco regional office and the Los Angeles area office.

Labor took no action on this lead. None of the Labor officials in San Francisco, Los Angeles, or headquarters we talked with about the September 1975 memorandum could recall it or recall specifically why investigative action was not taken. In San Francisco, we talked with the assistant regional administrator for PWBP, and in Los Angeles, we spoke with the area office administrator and a supervisory investigator who worked on the case. At Labor's headquarters, we spoke with the assistant administrator for LMSA's field operations division, PWBP's regional coordinator for the Office of Enforcement, and the chief of the Division of Reporting Enforcement, Office of Enforcement. The assistant regional administrator told us that Labor did not have ERISA enforcement guidelines or procedures in 1975 and that most of their staff time was spent performing technical assistance work--e.g., answering questions about the newly enacted (1974) statute--and not conducting compliance or enforcement activities, such as investigations of funds. The assistant regional administrator and the regional coordinator told us that the ERISA investigators that were employed in September 1975 did not have a high level of ERISA expertise and few investigations were started during this period. However, the chief of PWBP's Division of Reporting Enforcement, Office of Enforcement, told us that an investigation should have been started based on the information Labor had at the time about Mr. Shenker's alleged organized crime connections and about his loans from other pension funds. In addition, the assistant

administrator, Field Operations Division, said that he did not know why a case was not opened. Ordinarily, he told us, such a memorandum would lead to a case opening. In a 1980 deposition taken for this litigation, the assistant administrator for the Office of Enforcement said that, generally, the area office would verify the accuracy of such a report by visiting the union. We were unable to determine why no action was taken on the September 1975 memorandum.

Labor had access to other information
about problems with the Trust's
financial management

If Labor had started its investigation based on the September 1975 information, it would have had access to additional information that showed problems with the Trust's financial management. Based on this and other information, Labor could have acted more quickly to stop the Trust's flow of money to Shenker-controlled corporations.

In early 1976, the Trust's certified public accountants (CPAs), administrator, and lawyer expressed concerns about the Trust's financial management, primarily regarding the legality and collectibility of the loans to the Shenker-controlled corporations. The CPA's report of its examination of the Trust for the 2 years ended December 31, 1973 and 1974, dated July 31, 1975, showed that:

- The loans to Murrieta could be a violation of ERISA because, according to the CPA, Mr. Shenker "may be a party-in-interest."
- Murrieta had a net capital deficiency on May 31, 1975, of \$17,997,957 and a cumulative operating loss of \$16,487,196 from October 9, 1969, to May 31, 1975.
- Sierra had a net capital deficiency of \$4,016,531 at April 30, 1975.
- The Department of Housing and Urban Development had suspended Sierra's permit to sell real estate lots.

The CPA's report of its examination of the Trust for the 2 years ended December 31, 1974 and 1975, dated May 17, 1976, also showed similar problems.

In July 1975, according to the Trust controller's report, the trustees had instructed the Trust administrator to begin monitoring the Sierra investments. According to the administrator's report, the Trust was not aware that Sierra was selling real estate lots which were pledged as Trust collateral and substitute real estate collateral was being received. The Trust administrator hired a CPA to examine the Sierra investments. Between August 1975 and April 1976 the Trust's administrator pointed out many problems to the trustees as he started to monitor Sierra's investments.

1. In August 1975, the administrator questioned whether \$163,211.60 of \$217,972.32 Sierra disbursements were properly spent.
2. Sierra and Murrieta were delinquent on their payments to the Trust.
3. In an October 1975 report, the administrator's controller questioned "excessive salary" to Sierra's president and also pointed out that the Department of Housing and Urban Development had prohibited Sierra from engaging in any sales activity since July 1975.
4. In October 1975, the administrator sent a letter to the trustees highlighting what he believed were significant financial problems of the Shenker-controlled corporations.
5. In December 1975, the administrator started weekly monitoring trips to Sierra.
6. The controller reported to the administrator that he believed that all of Sierra's operations were not explained to the administrator or the trustees.
7. In April 1976, the controller reported to the trustees that Sierra had made some improvements in its financial management, but "there is still a long way to go before the trust can recover investment in Murrieta Hot Springs and Sierra Charter."

LABOR STOPPED TRUST DISBURSEMENTS
ON MARCH 30, 1977

Although Labor continued to receive information through December 1976 questioning the Trust's management, it did not start its onsite investigation until March 7, 1977. According to a Labor official, Labor believed that the alleged violations it found in March were of such a serious nature that immediate action was necessary. Consequently, Labor filed a civil lawsuit against the trustees, Mr. Shenker, and the Shenker-controlled companies on March 30, 1977. At that time the trustees agreed to stop funding the Shenker-controlled companies; however, more than \$10.1 million had been disbursed since Labor first learned of the problem in September 1975.

On May 25, 1976, the chief of PWBP's Division of Reporting Enforcement sent a memorandum to the Los Angeles area office administrator. The memorandum stated that Justice had provided Labor with the following information: Morris Shenker, well-known labor attorney with alleged organized crime connections, has been obtaining loans from the Culinary Workers Pension Fund through a Trust trustee. Attached to the memorandum was a financial analysis prepared by Labor of the Trust's annual reports for fiscal years ended December 31, 1973 and 1974, which showed over \$12 million in loans to Shenker-controlled corporations.

Two days later, the assistant administrator of the Office of Enforcement instructed the Los Angeles and St. Louis area offices to be alert to all of Mr. Shenker's financial arrangements with the Trust, the Teamsters Pension Fund, and the St. Louis Pipefitters Pension Fund and to send all information to headquarters for coordination. On June 17, 1976, the Los Angeles area office opened an investigative case to determine if the Trust had made loans to Shenker-controlled corporations and, if so, to examine the propriety of the financial arrangements. However, no work was done on the case and onsite investigation was delayed until March 1977 because a skilled investigator was not available.

In December 1976, a Department of Justice strike force representative (an investigator from Labor's Office of the Inspector General)¹ reported in a detailed memorandum to a Los Angeles area supervisor that he had received allegations from a Trust trustee regarding the loans. The memorandum stated that Mr. Shenker might be a party in interest and, therefore, prohibited from obtaining loans from the Trust.

"Mr. Shenker is the sole share holder of Murrieta Hot Springs and together with other members of his family, sole shareholder of Sierra Charter Corporation of Nevada. Mr. Shenker is a substantial shareholder of record of 38% of the stock in Continental Connector which owns the Dunes Hotel in Las Vegas. This Company is a contributor to the So. Nevada Culinary and Bartenders Pension Trust (Culinary Trust). He may be a party-in-interest as described in Section 3 (14) (H) of ERISA...."

The memorandum also described the loans and loan modifications that the Trust had made to Murrieta and Sierra, as well as the serious financial problems that both companies were experiencing.

Labor began its onsite investigation at the Trust on March 7, 1977. The assistant regional administrator told us that the investigation was delayed until March because much of his staff's time was spent providing technical assistance and because Labor area offices were not yet fully staffed with ERISA investigators.

After about 1 week of onsite investigative work, the PWBP administrator wrote to the Labor Under Secretary.

"On March 7, 1977, we briefed you on loans from subject fund to Morris Shenker, a St. Louis attorney who was closely associated with Jimmy Hoffa We currently are conducting a financial audit of the Fund and are convinced that Shenker related entities are milking the Fund.

¹The strike force brings together investigators from various federal agencies under the guidance of a Justice Department attorney in charge, in order to combat organized crime and racketeering.

Total assets of the Fund are \$37 million, of which \$31 million is loaned to Shenker entities. Fund assets are being loaned to Shenker in amounts of \$400,000 to \$800,000 monthly. Shenker is attempting to settle loans by turning over land of questionable value."²

On March 30, 1977, Labor initiated legal action by filing a complaint and a motion for preliminary injunction in the Las Vegas, Nevada, U.S. District Court. The defendants included 10 current and former trustees, Mr. Shenker, and four Shenker-related corporations (IJK, Murrieta, S&F, and Sierra). The motion for preliminary injunction had sought to stop the defendant trustees from further payment to Shenker-controlled companies and to take management of the funds away from the trustees. Labor attorneys obtained assurances from the Trust's attorneys that the trustees would not advance more money to Shenker-controlled corporations. The associate solicitor told us that Labor agreed not to pursue the motion because it verified that the trustees had stopped funding the Shenker corporations and because the trustees agreed to appoint an independent asset manager to manage the Trust's real estate assets. The trustees retained control over the cash used to pay member benefits and Trust administrative expenses.

CONCLUSIONS

We recognize that during 1975 and 1976, Labor staff spent most of its time performing technical assistance work on ERISA and not conducting enforcement activities. However, in view of the continuing allegations regarding the Trust's activities, we believe that Labor should have started its investigation sooner. Between September 1975 and March 1977, the Trust disbursed \$10.1 million of the total \$24.9 million to Shenker-controlled companies.

²Mr. James Hoffa was former president of the International Brotherhood of Teamsters, Chauffeurs, Warehousemen, and Helpers of America Union and a trustee of the Teamsters' Central States, Southeast and Southwest Areas Pension Fund. He was convicted and served a prison sentence for fraudulent abuse of the Teamsters' pension fund assets.

THE SOLICITOR'S OFFICE ROLE IN THE SELECTION OF
THE TRUST'S TWO ASSET MANAGERS

Labor does not have departmental policy or guidance regarding its role and responsibility in the search for and selection of asset managers. Solicitor's Office attorneys participated in the search for the Trust's first asset manager, UAB, but were less involved in the selection of Karsten, the second asset manager. Labor's role in the selection of both of these asset managers was largely determined on an "ad hoc" basis by Solicitor's Office attorneys.

THE SEARCH FOR THE TRUST'S
FIRST ASSET MANAGER

Labor's March 1977 motion for preliminary injunction sought to take management of the Trust's funds away from the trustees. After discussions among representatives of the Trust, the trustees, and Labor, an agreement was reached regarding the appointment of an independent asset manager. They agreed that the asset manager would be chosen by the trustees, agreed to by Labor, and approved by the court. If Labor objected to the selection, its attorneys could present the court with the reasons for the objection. After hearing the arguments, the court would approve or disapprove the trustees' selection.

In June 1977, the trustees reviewed the proposals of several prospective asset managers. On the recommendation of their attorneys, the trustees selected Mortgage Banque, Inc., of Houston, Texas. Labor did not object to this selection and a stipulation (a legal instrument stating conditions or requirements) naming the bank as asset manager was drafted. In early July, however, Mortgage Banque requested modifications in the stipulation which neither the trustees nor Labor accepted. Mortgage Banque withdrew its proposal.

The trustees began a new search for an asset manager. According to the trustees, the number of candidates qualified and willing to take the job was very limited. Labor's attorneys assisted in the search at this point. The attorneys told us that Labor talked with many potential asset managers, or firms that could function as asset managers, but the "real good ones" did not want to tackle the Trust's problems. Labor's attorneys said that Labor had no departmental guidelines to follow except

that the supervisory attorneys, including the associate solicitor, said that they wanted "a bank with deep pockets"--a bank with enough assets that if it mismanaged the Trust, Labor could recover the money from the bank.

According to UAB's former executive vice president who handled the Trusts' assets, UAB first learned that the Trust and Labor were searching for an asset manager from a third party, a Chicago attorney. The executive vice president said that the attorney contacted him and told him that Labor was looking for an asset manager and that UAB might have a chance of obtaining the job. A meeting was set up in Las Vegas between UAB's vice president and a Labor attorney. At the meeting, UAB's vice president and the Labor attorney discussed the Trust's problems, what Labor was looking for in an asset manager, and what UAB's fee would be for the work. (UAB's vice president said later, in his deposition for the trial, that he felt Labor was looking for someone with enough assets that, if a problem arose, the Trust would be protected.) UAB's vice president and the attorney who set up the discussion met with the trustees later, at a separate meeting.

UAB made a presentation to the trustees, and in August 1977, UAB's proposal was adopted and signed by the trustees. A stipulation was executed by the trustees, Labor, and UAB and approved by the court on August 30, 1977.

THE SEARCH FOR THE SECOND ASSET MANAGER

In March 1978, UAB notified Labor that it wanted to resign as asset manager because the job was taking more time than expected and because it was not profitable.

In August 1978, the Trust received proposals from two firms (Marrinson and Associates and Karsten). Marrinson and Associates' president, Mr. Allen Marrinson, was UAB's former executive vice president and had handled the Trust's assets for UAB. He had left UAB and founded the law firm of "Marrinson and Associates." One of Mr. Marrinson's associates was the attorney who had set up the meeting in Las Vegas between UAB and the Labor attorney. After that meeting, UAB hired the attorney to help Mr. Marrinson handle the asset manager work. At the time that Marrinson and Associates submitted its proposal in August 1978, this attorney was being investigated by UAB regarding some questionable billings of the Trust. (The attorney later agreed to pay back about \$15,000 to the Trust because of poor bookkeeping.)

Labor did a financial check on Karsten. In August 1978, Karsten's combined net worth was about \$900,000 and was covered by fiduciary liability insurance. Records available to us did not disclose Marrinson's net worth, however, according to a trustee, Marrinson lacked "financial depth."

In September 1978, the trustees, after hearing presentations by Marrinson, Karsten, and a third prospective manager, selected Marrinson. Minutes of the trustees' meetings did not disclose the reasons for this selection. In October 1978, Labor wrote a letter to the trustees expressing disagreement with the selection. Labor's reasons for disagreeing were Mr. Marrinson's partnership with the attorney, minimal capital, limited real estate experience, lack of loyalty to the Trust, lack of understanding of conflict of interest, and misrepresentation.

On November 7, 1978, the trustees selected Karsten as the Trust's asset manager. Labor did not object to this new selection, and the court approved Karsten in April 1979. Karsten was acquired by First Interstate Bank in 1983.

CONCLUSIONS

Our review of Labor's involvement in the Trust's selection of its asset managers disclosed that Labor's role was largely determined on an "ad hoc" basis by Solicitor's Office attorneys, not by a formal Labor policy. Labor does not have policy or guidance regarding the role of Labor in the search for and selection of asset managers. Our review, however, was limited to one fund, and we do not know if this lack of formal policy is a problem.

LABOR'S ROLE IN MONITORINGTHE TRUST'S ASSET MANAGER

Although Labor requested and received court-approved provisions that required the asset managers to periodically report Trust investment activities to the department, it did not develop a strategy to receive, evaluate, and, if necessary, act on this information.

Consequently, there were disagreements among the Labor officials who performed the various monitoring activities regarding which office, Solicitor's or PWBP, should perform the monitoring, how it should be accomplished, and what action Labor should take regarding potentially imprudent investments.

UAB WAS REQUIRED TO REPORT
CERTAIN TRANSACTIONS

UAB was required to (1) provide monthly activity reports to the trustees and Labor and (2) report transactions with any party in interest to Labor and IRS under a special exemption procedure.

The August 30, 1977, stipulation, which named UAB as asset manager, included a provision that the asset manager notify Labor and the trustees 5 days prior to implementing any proposed transaction exceeding \$100,000. If either Labor or the trustees objected to the transaction, the asset manager was to notify the objecting party of its decision and wait at least 24 hours (or 1 full business day) before completing the transaction. The stipulation also required the asset manager to develop an overall plan for the management and/or disposition of Trust assets. The 5-day notice requirement was not required in the asset management plan that was approved by the court in April 1978. The asset manager was, however, required to provide monthly activity reports to the trustees and Labor that were to include a report of each transaction entered into or action taken involving real estate-related assets. On April 7, 1978, Labor asked the court to reimpose the notice requirement on the asset manager, but the court declined because of the monthly reporting requirements imposed by the asset management plan.

UAB applied to Labor and IRS for an ERISA exemption to allow it to engage in transactions with certain parties in interest, which would be "necessary to 'work out' a number of troubled loans and other assets" held by the Trust. Under ERISA, Labor is required to establish an exemption procedure for

fund transactions that would otherwise be illegal if an exemption was not granted. Labor must coordinate with IRS and cannot grant an exemption unless it is:

- administratively feasible,
- in the interests of the fund and of its participants and beneficiaries, and
- protective of the rights of participants and beneficiaries of such fund.

The exemption was granted by Labor and IRS on June 26, 1978, and provided that the asset manager report "within thirty days, transactions with any party-in-interest or disqualified person which constitute a continuation, reconfirmation or adjustment of any arrangement relating to a Pension Trust."

LABOR IDENTIFIED PROBLEMS WITH THE TRUST'S REAL ESTATE TRANSACTIONS

Several Labor offices were involved in looking at the asset manager's activities, including PWBP's Offices of Enforcement and Fiduciary Standards, LMSA's Office of Management, the Solicitor's Office, and the Los Angeles area office. Two real estate transactions caused disagreement among Labor officials in these offices. Potential problems were identified regarding these two transactions, but Labor did not develop a plan for evaluating and acting on the information it received. In addition, Labor officials did not agree on what should be done about the problem transactions. Labor's monitoring activities regarding these two real estate investments made by UAB in 1978 are discussed in this section.

In March 1978, after reviewing the asset management plan, the chief of PWBP's Division of Reporting Enforcement, who had been involved in the initial investigation, expressed disagreement with three real estate transactions proposed by the asset manager. The transactions involved the Trust's collateral. The chief and two area office investigators questioned an investment of approximately \$1 million in a land development project in Oregon, about which they had little information. They believed that this transaction should not take place without Labor obtaining more detailed information.

On March 23, 1978, one of these investigators visited the asset manager, but was unable to obtain such information. The investigator reported that the Trust's investments appeared to

be handled outside of the asset manager's trust department's normal course of business. He told us he could not obtain the detailed information during his March 1978 visit to the asset manager because the Trust's recordkeeping was inadequate, the management and accounting controls were weak, and he did not understand how the Trust's investment activities met the bank's trust standards. Although these questions remained regarding the real estate transactions and the asset manager's handling of the account, the asset manager went ahead with the Oregon development project. Labor could have objected to the transactions in court, but did not. We examined available records and discussed this matter with the attorney in charge of the case, but we could not determine why Labor did not object.

In May 1978, the chief of PWBP's Division of Reporting Enforcement, after reviewing a 1978 asset manager report, stated that "from a review as to how UAB is handling this account, the writer believes that the Trust is going to suffer large losses." In June 1978, the asset manager proposed another land development project, an investment of \$3.6 million, which the Office of Enforcement was skeptical about. The office reported that "these land transactions appear to benefit Shenker more than the Culinary Fund. Both of the transactions [this project and the Oregon project] appear to be 'orchestrated' by Shenker, not UAB." In July 1978, PWBP and the Solicitor's Office staff met to discuss these concerns. At the meeting, PWBP and the attorneys disagreed as to what future monitoring Labor should perform, if any. The PWBP administrator suggested that Labor should either "toughen up reporting requirements" or obtain a "real estate expert to look at the two most recent transactions."

In August 1978, a financial analyst from LMSA's Office of Management, who was evaluating PWBP's Office of Enforcement, discovered that the chief of Reporting Enforcement had raised serious concerns about the Trust's investments, but these concerns, in the analyst's opinion, had not been resolved. The financial analyst told us that he checked with the Office of Fiduciary Standards and the Solicitor's Office to determine which office was monitoring the Trust's investments. He found that neither office was monitoring--each office believed it was the other's responsibility. He suggested to the PWBP administrator that Labor should start systematically monitoring the activities of the asset manager.

An LMSA analyst with a real estate investment background was selected by the administrator to perform an indepth analysis of the reports submitted by the asset manager. In meetings from

September 1978 through January 1979 and in written reports in March and April 1979, the analyst reported his conclusions to the PWBP administrator. He reported that the asset manager's real estate investment strategy was "not supported by financial analysis or apparently a thorough analysis of probable outcome." Several staff members analyzed the available raw data to establish through financial analysis whether the selected course of action was in the best interest of the Trust. Based on this data, the analyst concluded that there were, assuming the most likely conditions, probable losses of \$2 million to \$3 million on one transaction. On the other transaction he thought the Trust would incur \$8 million to \$10 million in additional liabilities. In the event the development could not be sold, the Trust would have this amount exposed to possible loss.

On July 2, 1979, the assistant administrator of the Office of Fiduciary Standards reported to the PWBP administrator that his office had been requested by the former PWBP deputy administrator to review the report prepared by the analyst. The assistant administrator reported that his office disagreed with the analyst's findings. He also reported, however, as did the analyst, that there was not enough information on which to base a final conclusion. Documents available to us did not show that Labor had obtained additional information and the assistant administrator told us he did not know whether Labor had obtained such information.

UAB completed both of the transactions that some Labor officials found questionable. When Karsten became asset manager in April 1979, it attempted to work out the problems with both developments. In May 1981, Karsten calculated a net loss of \$309,500 on the \$3.6 million investment. According to Karsten, the estimate was based on a number of contingencies and highly speculative. It assumed that the homebuilding project covering all lots would be successful and that all lots would be sold over a 9-year period. Karsten calculated a net profit of \$225,000 on the \$1 million investment. This estimate assumed that the property would receive the needed zoning approval from the state land development commission.

GAO INQUIRIES DID NOT PROMPT
PWBP OR THE SOLICITOR'S OFFICE
TO MONITOR THE ASSET MANAGER, KARSTEN

Although several Labor offices and officials were involved in looking at various aspects of UAB's activities, no one had or took the overall responsibility. When Karsten became asset manager in 1979, it became subject to the same monthly reporting

requirements as UAB. During our review in 1982, we became concerned about the lack of a planned and coordinated review of Karsten's activities. We discussed this with Labor officials, including the PWBP administrator at that time and the associate solicitor in charge of this litigation. We talked with the associate solicitor in May 1982 and the PWBP administrator in June 1982. Solicitor's Office officials told us that monitoring exemption reports and asset management reports is not the responsibility of their office, although they do review the asset management reports for their potential impact on the pending litigation. The PWBP administrator told us that his office was not monitoring the activities of the asset manager because the Solicitor's Office was handling the case. He said that if the Solicitor believes monitoring should be performed, he should tell PWBP. As of March 1984, PWBP and the Solicitor's Office had not decided who, if anyone, should be monitoring the asset manager's activities.

CONCLUSIONS

PWBP and the Solicitor's Office did not establish procedures to provide a planned and coordinated effort to monitor the Trust's asset manager's activities. Consequently, we believe their efforts to ensure the safety of the Trust's assets were hindered. However, because our review was limited to one fund, we do not know how widespread or significant this problem may be.

EFFORTS BY LABOR TO SETTLE
WITH THE DEFENDANTS

Since 1980 there have been several settlement discussions between Labor and Mr. Shenker and between Labor and the Trust's trustees and attorneys. The current asset manager and Mr. Shenker have also discussed settlement.

SETTLEMENT DISCUSSIONS WITH MR. SHENKER

In May 1980, after discussions between Mr. Shenker's attorneys and Labor, Mr. Shenker's attorneys proposed to Labor that a \$10 million payment to the Trust was acceptable to Mr. Shenker in settlement of all liabilities to the Trust. A Labor attorney responded to Mr. Shenker that the amount must be substantially higher. These negotiations ended at this point.

In late 1980 and early 1981, Labor and Mr. Shenker had further settlement discussions. A Labor attorney wrote to Mr. Shenker's attorney in March 1981 that \$18 million in cash and the Trust's retention of all collateral (valued at that time by the Trust's asset manager at approximately \$11 million) was the minimum acceptable settlement to the Trust. Mr. Shenker rejected that offer. The supervisory Labor attorney in charge of the case told us that because Mr. Shenker and Labor were "so far apart," settlement discussions were dropped. Since March 1981, Labor has not discussed settlement with Mr. Shenker. According to the supervisory Labor attorney, the current asset manager, Karsten, and Mr. Shenker had many settlement discussions.

SETTLEMENT DISCUSSIONS WITH THE
TRUSTEES AND TRUST ATTORNEYS

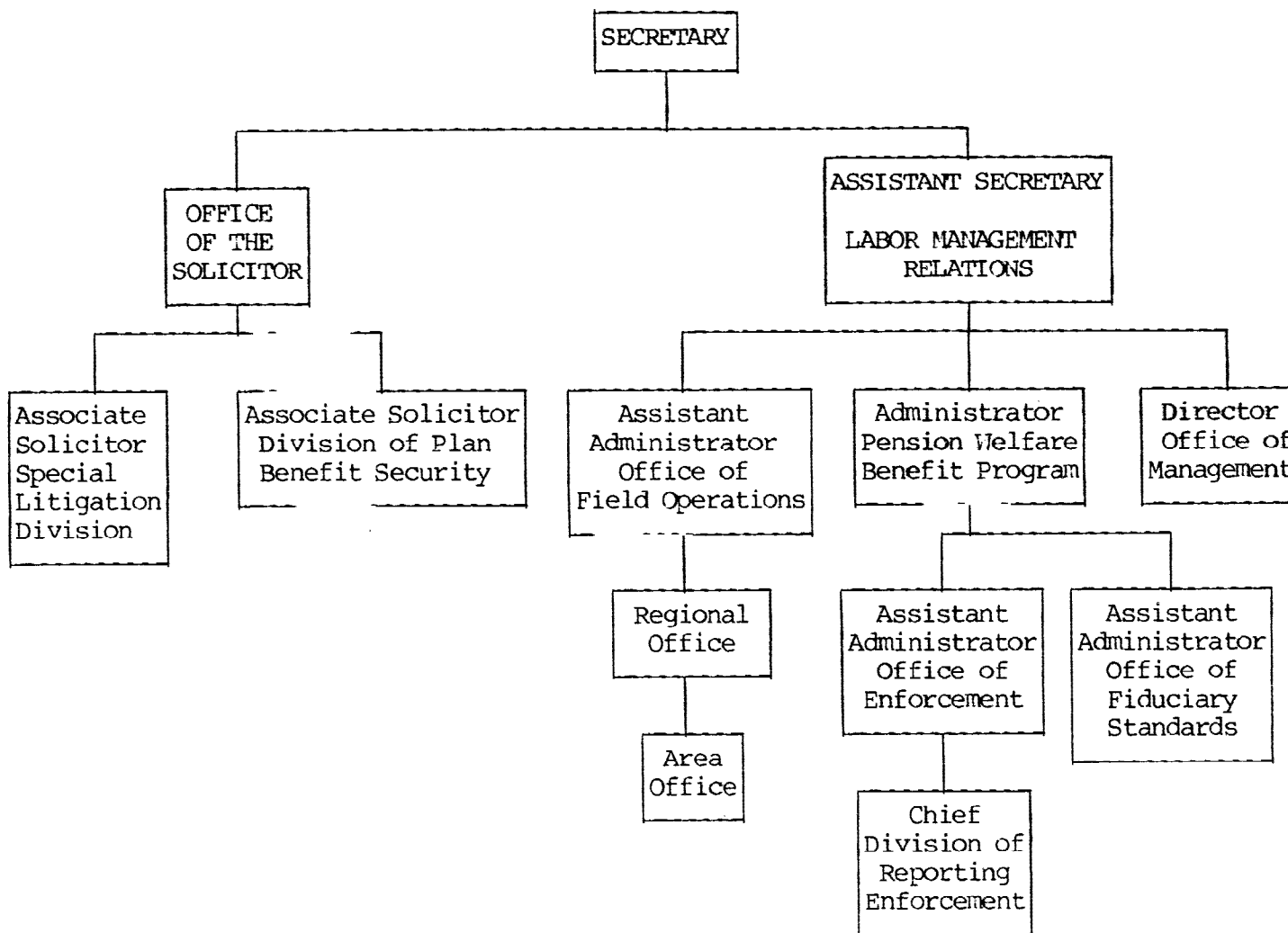
In September 1981, Labor began settlement discussions with the defendant trustees and Trust attorneys. The supervisory Labor attorney handling the case told us that Labor was seeking both financial restitution from the defendants and injunctive relief for the Trust. In February 1983, Labor announced a settlement and consent decree (an agreement entered into by consent of the parties under sanction of the court) resulting in a payment of \$3.7 million in restitution to the Trust. This sum was paid to the Trust by the defendants' fiduciary liability insurance and the Trust attorneys' malpractice insurer. Seven of the 10 named defendant trustees and the two Trust attorneys (who had advised the Trust in connection with the loans to

Shenker-controlled corporations) were involved in the monetary settlement. One defendant trustee, whose case was decided on April 2, 1984, and two other defendant trustees, who had been dismissed from the case earlier, were not involved in this settlement.

The consent decree provided for injunctive relief against three defendant trustees, barring two of them from serving as fiduciaries for any ERISA fund for 5 years and barring one from serving as fiduciary for any fund, except the Trust, for 5 years, as long as the Trust's investments were handled by an asset manager. It also limited the attorneys' activities with regard to ERISA funds for 4 years. In addition, the consent decree required the Trust to have most of its assets managed by a professional asset manager, as defined by ERISA, for 5 years.

The April 1984 judgment against the defendant trustee barred him from serving as a trustee for an ERISA-covered plan for 5 years.

PRINCIPAL DEPARTMENT OF LABOR OFFICES
INVOLVED IN THE ACTIVITIES DISCUSSED IN THIS REPORT



PRINCIPAL DEPARTMENT OF LABOR
OFFICIALS RESPONSIBLE FOR
THE ACTIVITIES DISCUSSED IN THIS REPORT

	<u>Tenure of office</u>	
	<u>From</u>	<u>To</u>
<u>Office of the Secretary of Labor</u>		
Secretary of Labor:		
Raymond J. Donovan	Feb. 1981	Present
Ray Marshall	Jan. 1977	Jan. 1981
William J. Usery, Jr.	Feb. 1976	Jan. 1977
Under Secretary of Labor:		
Ford Barney Ford	July 1983	Present
(Vacant)	Apr. 1983	July 1983
Malcolm R. Lovell, Jr.	Sept. 1981	Mar. 1983
(Vacant)	Feb. 1981	Aug. 1981
John Gentry	Oct. 1979	Jan. 1981
(Vacant)	Sept. 1979	Sept. 1979
Robert J. Brown	Mar. 1977	Aug. 1979
<u>Labor-Management Services</u>		
<u>Administration</u>		
Assistant Secretary for Labor- Management Relations:		
(Vacant)	Mar. 1983	Present
Donald L. Dotson	May 1981	Mar. 1983
(Vacant)	Feb. 1981	Apr. 1981
William Hobgood	July 1979	Jan. 1981
(Vacant)	Feb. 1979	June 1979
Francis X. Burkhardt	Mar. 1977	Jan. 1979
Bernard E. Delury	Apr. 1976	Feb. 1977
Deputy Assistant Secretary for Labor-Management Relations:		
Ronald J. St. Cyr	May 1981	Present
Hilary M. Sheply (Acting)	Jan. 1981	May 1981
(Vacant)	Sept. 1980	Dec. 1980
Rocco C. DeMarco	Apr. 1979	Aug. 1980
J. Vernon Ballard (Acting)	Mar. 1979	Mar. 1979
Jack Warshaw	May 1976	Mar. 1979

	<u>Tenure of office</u>	
	<u>From</u>	<u>To</u>
Deputy Assistant Secretary for Program Operations: ^a		
(Vacant)	Jan. 1984	Present
John J. Walsh	Nov. 1982	Jan. 1984
Administrator, Pension and Welfare Benefit Program: ^b		
Robert A.G. Monks	Dec. 1983	Present
Alan D. Lebowitz (Acting)	Sept. 1983	Dec. 1983
Jeffery N. Clayton	Dec. 1981	Sept. 1983
Ian D. Lanoff	May 1977	Dec. 1981
J. Vernon Ballard (Acting)	Jan. 1977	May 1977
Deputy Administrator, Pension and Welfare Benefit Program:		
Morton Klevan	Mar. 1980	Present
(Vacant)	Jan. 1980	Feb. 1980
J. Vernon Ballard	Dec. 1974	Dec. 1979
<u>Office of the Solicitor</u>		
Solicitor of Labor:		
Francis X. Lilly	Mar. 1984	Present
(Vacant)	May 1983	Mar. 1984
Timothy Ryan	Mar. 1981	Apr. 1983
Carin A. Clauss	Mar. 1977	Jan. 1981
Alfred Albert (Acting)	Jan. 1977	Mar. 1977
William J. Kilberg	Apr. 1973	Jan. 1977
Deputy Solicitor:		
(Vacant)	Mar. 1984	Present
Francis X. Lilly	Jan. 1982	Mar. 1984
(Vacant)	Apr. 1981	Dec. 1981
Alfred G. Albert	Sept. 1970	Apr. 1981
Associate Solicitor, Division of Plan Benefits Security:		
Robert Eccles (Acting)	Aug. 1982	Present
Monica Gallagher	Nov. 1977	Aug. 1982
Steven J. Sacher	Feb. 1975	Aug. 1977

Tenure of office
From To

Associate Solicitor,
Special Litigation Division:

David H. Feldman	July 1981	Present
Richard O. Patterson(Acting)	Mar. 1981	July 1981
Mike Stewart	Oct. 1980	Feb. 1981
Monica Gallagher (Acting)	May 1980	Sept. 1980

LMSA Investigation Staff--Los Angeles

Administrator, Area Office:

Ricki Curry	July 1980	Present
(Vacant)	Aug. 1979	June 1980
Kenneth Evans	Jan. 1977	Aug. 1979
(Vacant)	Oct. 1976	Jan. 1977
Terrence Martin	Oct. 1975	Oct. 1976

Position established in November 1982.

WPBP is a separate unit within the Department of Labor as of May 20, 1984.

29477

AN EQUAL OPPORTUNITY EMPLOYER

UNITED STATES
GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

OFFICIAL BUSINESS
PENALTY FOR PRIVATE USE, \$300

POSTAGE AND FEES PAID
U. S. GENERAL ACCOUNTING OFFICE



THIRD CLASS