EMPLOYEE BENEFITS DEVELOPMENTS MARCH 2013

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Practices & Industries

Employee Benefits

RULINGS, OPINIONS, ETC.

Department of Health and Human Services Issues Final HIPAA Privacy and Security Regulations

Under the privacy and security provisions of the Health Insurance Portability and Accountability Act (HIPAA) "covered entities," including employer sponsored self-insured group health plans, are required to establish certain procedures to safeguard protected health information. On January 25, 2013, the Department of Health and Human Services issued final regulations regarding HIPAA privacy and security provisions. These final regulations replace, and in some cases differ from, the prior existing guidance. Some of the changes under the new regulations include a broadening of the business associate definition, the application of all security provisions directly to business associates, a change to the process for determining if a breach has occurred, the addition of new rights for individuals to access and restrict the disclosure of protected health information, and new restrictions on information that can be disclosed by a plan for underwriting purposes. In light of the new final regulations and the changes they include, it is important for employers to review and amend as necessary the HIPAA compliance documents and practices that govern their self-insured health plans.

Specifically, the following documents should be reviewed and amended as necessary:

- Notice of Privacy Practices
- HIPAA Privacy and Security Policy
- Business Associate Agreements

In addition to document review, employers should evaluate their risk assessment and HIPAA training programs to confirm they are up to date with the recent changes to the law. These new regulations are generally effective September 23, 2013.

IRS Updates EPCRS Process

With the issuance of Rev. Proc. 2013-12, the Internal Revenue Service (IRS) updated the Employee Plans Compliance Resolution System (EPCRS). There were few surprises in the long-awaited guidance. However, a number of updates warrant mention.

One significant update was to the forms used for Voluntary Correction Program (VCP) submissions. New IRS Forms 8950 (Application for VCP) and 8951 (Compliance Fee for Application for VCP Submission Under the EPCRS) are required to be used for VCP submissions made on or after April 1, 2013. Together with the model compliance statement and accompanying schedules found in new EPCRS Appendix C, the Forms 8950 and 8951 should allow for a more efficient submission process.

The preceding version of EPCRS under Rev. Proc. 2008-50 was issued prior to the requirement that 403(b) plans be maintained pursuant to a written plan document. To the extent the written plan document requirement for a 403(b) plan was not timely met, the updated EPCRS provides that a VCP submission regarding this failure submitted no later than December 31, 2013, may be eligible for a 50 percent reduced VCP fee. In addition, the new EPCRS is updated to generally permit plan sponsors of 403(b) plans to correct a failure in the same manner that the same failure could be corrected for a qualified retirement plan.

Submissions for governmental 457(b) plans continue to be accepted by the IRS on a provisional basis outside of EPCRS, albeit through standards that are similar to EPCRS. The IRS generally will not accept submissions for tax-exempt 457(b) plans. However, the IRS indicates that it may consider a submission if a plan was erroneously established to benefit the tax-exempt entity's non-highly compensated employees, and the plan has been operated in a manner similar to a qualified retirement plan.

With respect to 401(k) plans, in the case of an employee who was eligible for but did not receive an allocation of employer matching contributions under a non-safe harbor plan because he or she was not given the opportunity to make elective deferrals, the updated EPCRS allows an employer to make a corrective employer matching contribution that remains subject to the plan's vesting schedule. Rev. Proc. 2008-50 had previously required an employer to make a qualified nonelective contribution (QNEC) on behalf of an employee in this circumstance. Employees are required to be 100 percent vested in QNECs at all times.

In the case of single employer defined benefit plans, the funding-based limitations under Internal Revenue Code Section 436 and Employee Retirement Income Security Act of 1974 (ERISA) Section 206(g) could act to block certain forms of correction that are otherwise available where a plan is underfunded. EPCRS addresses the issue and tracks the statute in requiring an employer to make a contribution to the plan in order for the otherwise-available method of correction to be available.

DOL Updates Delinquent Filer Voluntary Compliance Program

The Department of Labor (DOL) is statutorily authorized to assess civil penalties of up to $1,100 per day against plan administrators who fail to file complete and timely Form 5500s (Annual Return/Report of Employee Benefit Plan). Pursuant to this authority, the DOL maintains an enforcement program under which plan administrators who *fail to file* a Form 5500 may be assessed a penalty of up to $300 per day, up to $30,000 per year, until a complete Form 5500 is filed. Plan administrators who *file a late* Form 5500 may be assessed up to $50 per day for each day the Form 5500 is filed after the date on which it was required to be filed, without regard to any extensions of time for filing.

Designed to encourage voluntary compliance by plan administrators, the DOL has maintained a Delinquent Filer Voluntary Compliance Program (DFVCP) since 1995 that allows plan administrators to file delinquent annual returns while potentially incurring substantially reduced penalties. The DFVCP was amended in 2002 and has now been amended again. The latest changes are effective January 29, 2013.

Prior to the requirement that all Forms 5500 be filed electronically through the DOL's EFAST2 filing system, delinquent filers had the option of submitting a late Form 5500 using the current year's forms or the correct prior year's forms. Now that all Form 5500s are required to be filed through the EFAST2 system, delinquent filers may be required to use the current year Form 5500 while attaching prior year schedules for the relevant plan year. To aid delinquent filers in determining which forms and schedules must be submitted, the DOL has added an online tool that helps identify the proper Form 5500 and schedules. The updates to the DFVCP also incorporate the already-existing DFVCP penalty calculator and online payment option available through the DOL's website. Plan administrators participating in the DFVCP retain the option to mail the applicable penalty amount with a copy of the filed Form 5500(s) (without schedules or attachments).

The DFVCP penalty structure remains the same under the updated DFVCP.

Type of DFVCP Submission

Daily Penalty

Maximum Annual Report Penalty

Maximum Plan Penalty

Small Plan (i.e., generally fewer than 100 participants)

$10

$750

$1,500

Large Plan (i.e., generally 100 or more participants)

$10

$2,000

$4,000

Small Plan Sponsored by 501(c)(3) Organization

$10

$750

$750

CASES

Employee Not Entitled to COBRA Penalties

The Eighth Circuit Court of Appeals upheld a district court's ruling that a terminated employee who did not receive timely COBRA notices was not entitled to civil penalties. Under COBRA, when a participant commences coverage under a group health plan, the plan administrator is required to provide an initial COBRA notice explaining the individual's COBRA rights. COBRA also requires a plan administrator to provide a COBRA election notice to individuals who lose coverage as the result of a qualifying event, such as the termination of employment. In this situation, it was undisputed that the employer failed to provide these two required COBRA notices. However, the employer also mistakenly continued the former employee's coverage for a period of two years at no cost. ERISA provides that a plan administrator that fails to meet the COBRA notice requirements may at the court's discretion be personally liable to such participant in the amount of up to $110 a day from the date of such failure. In this situation, however, the court decided not to impose a penalty on the plan administrator, noting that the former employee was not harmed by the employer's failure to provide the timely COBRA notice. The court further noted that the former employee received a significant benefit by receiving two years of continuation coverage at no cost. Although the plan administrator was not assessed a penalty in this case, it serves as a reminder for employers to establish and follow their COBRA notice procedures. (*In re Interstate Bakeries Corp*., 8th Cir. 2013)

Court Denies ERISA Claims Involving a Plan Sponsor's Imprudent Investment Decisions

A group of participants in the Bank of America (BOA) 401(k) and pension plans commenced a lawsuit alleging BOA engaged in prohibited transactions and breached its fiduciary duty by selecting and maintaining BOA-affiliated mutual funds in the investment mix for the plans, despite the availability of other investment options that performed better while charging lower fees.

BOA moved to dismiss the pension plan claims on the basis that the participants had not identified any actual injury and therefore had no standing to sue. The Fourth Circuit Court of Appeals agreed with BOA that the participants failed to identify any injury under the pension plan the courts could remedy. The court ruled the pension plan participants could not show an injury in fact because benefits under a defined benefit pension plan are not affected by the performance of the plan's underlying investments. The court rejected the argument that injury occurs because there is a risk the pension plan might fail on account the investment selections, which would jeopardize plan benefits.

BOA also contended that the 401(k) plan claims were barred by the applicable statute of limitations under ERISA. Again, the court agreed with BOA. Initial selection of the BOA-affiliated funds for inclusion in the 401(k)plan investment lineup triggered the running of the limitations period, and that clearly had occurred outside the limitations period. The participants argued, however, they could still bring an action because a new prohibited transaction and breach of fiduciary duty occurred every time the plan committee met and did not remove the BOA-affiliated funds from the 401(k) plan's offerings. The court rejected this argument, ruling that the alleged prohibited transactions and breach could only be based on the initial selection of the funds. To establish their claim based on the committee's failure to remove the funds, the court ruled that the participants must "show that a fiduciary caused the plan to engage in the allegedly unlawful transaction." The court ruled that a decision to continue certain investments, or a defendant's failure to act, cannot constitute a "transaction." (*David v. Alphin*, 4th Cir. 2013)

PBGC Properly Denied Shutdown Benefits

Eveleth Mines, LLC operated a taconite pellet production plant used in the production of iron and steel. In 2003, Eveleth saw a huge reduction in its business when two primary customers began purchasing taconite from other sources. In February 2003, Eveleth sent the union representing approximately 400 hourly employees a letter advising that Eveleth would permanently close its mining operation on or about May 14, 2003 due to lack of orders. In March 2003, Eveleth sent a notice to its employees that the closure was expected to be temporary, but only if pellet orders were received during the shutdown period. In May 2003, Eveleth and its subsidiaries filed for bankruptcy protection.

The Pension Benefit Guaranty Corporation (PBGC) acted to terminate the defined benefit pension plan of Eveleth to protect the plan's financial position. When issuing a notice of benefits to plan participants, the PBGC did not include the "shutdown benefit" contained in the plan. (Shutdown benefits are a form of subsidized early retirement benefits applicable when a plant or company permanently shuts down its operations.) The PBGC had concluded that permanent shutdown benefits would result in additional $70 million in benefits, about $35 million of which would be guaranteed by the PBGC. The union challenged the PBGC determination.

The Court of Appeals for the District of Columbia Circuit upheld the PBGC's determination. A key factor in the court's decision was the deference to be given to the PBGC determination. The Court found that an agency's determination would be upheld if there is relevant evidence as a reasonable mind might accept as adequate to support the agency's finding. While the court stated that if it was making its own determination, it might find that a permanent shutdown had occurred, applying the correct legal standard of deference given to an agency determination provided evidence to support the agency's finding. (*USW v. Pension Benefit Guaranty Corporation*, D.C. Cir., 2013).

ERISA Does Not Preempt Shareholder Derivative Action for ESOP Participants

Mattingly Foods, Inc. was a corporation that distributed food and restaurant products throughout the state of Ohio. Mattingly maintained an employee stock ownership plan (ESOP) that held an interest in Mattingly from 1999-2012. A participant in the plan alleged that certain officers, directors, and shareholders of Mattingly engaged in misconduct that eventually led to the ESOP's sale of the Mattingly stock at a lower value. The participant sued the officers and directors in a shareholder derivative action to recover the loss in value suffered as a result of the alleged misconduct. The action was brought in state court in Ohio. The defendants attempted to remove the case from state court to a federal court, arguing the claims were really governed by ERISA and federal jurisdiction applied. The magistrate judge for the District Court for the Southern District of Ohio has recommended to the district court that it remand the case to state court to proceed on the shareholder derivative action. The magistrate's recommendation is based on a recent Sixth Circuit case that held ERISA does not preempt state law shareholder derivative suits brought by corporate employees who, by reason of their participation in ESOP, are treated as company shareholders. The forum in which the case is held may be important for the parties in the case. In many situations, remedies under ERISA are much more limited than those that could be imposed in a state court action. Therefore, many defendants try to remove a case to federal court and have the terms of ERISA apply to limit the amount of any award that could be imposed should liability be found. The recent Sixth Circuit decision and this magistrate's recommendation indicates that participants alleging mismanagement and reduction in employer stock held within a plan may be a cause of action that lies within a state court shareholder derivative suit. (Rodgers v. Mattingly Foods Inc., S.D. Ohio, 2013)

Employee Benefits Practice Group

Peter K. Bradley pbradley@hodgsonruss.com
Anita Costello Greer agreer@hodgsonruss.com
Michael J. Flanagan mflanagan@hodgsonruss.com
Richard W. Kaiser rkaiser@hodgsonruss.com
Arthur A. Marrapese, III art_marrapese@hodgsonruss.com
Ryan M. Murphy rmurphy@hodgsonruss.com