EMPLOYEE BENEFITS DEVELOPMENTS NOVEMBER 2012

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Practices & Industries

Employee Benefits

RULINGS, OPINIONS, ETC.

Hurricane Sandy Relief Provided

The Internal Revenue Service (IRS) has announced relief to allow for easier loan and hardship distributions for those impacted by Hurricane Sandy for 401(k) plans and other similar employer sponsored retirement plans. The relief applies to participants, their spouses, dependents, or lineal ascendants or descendants who live or work in a county or tribal nation that has been identified as a covered disaster area. A listing of covered disaster areas can be found at the IRS website.

Relief granted is for certain hardship distributions (other than amounts relating to Qualified Nonelective Contributions or Qualified Matching Contributions) and provides that any hardship that arises from Hurricane Sandy for the participant, spouse, or lineal ascendants or descendants will be treated as an unforeseeable emergency unless the plan administrator has actual knowledge to the contrary. Additionally, the requirement to suspend a participant from making salary reduction contributions for at least six months following a hardship distribution is not required. With respect to plan loans, plans are not required to follow plan procedural requirements if they make a good faith diligent effort under the circumstances to comply with those requirements. Hardship distributions and loans under this relief must be made on or after October 26, 2012 and no later than February 1, 2013. Plans that do not have hardship or loan provisions currently in the plan document may provide for hardship and loans under this relief with the amendment documenting the loan and hardship provisions not being required until the last day of the plan year beginning in 2013. (IRS Announcement 2012-44)

IRS Addresses Wage Recharacterization in Expense Reimbursement Plans

The IRS recently issued a revenue ruling explaining that expense reimbursement arrangements that recharacterize taxable wages as nontaxable reimbursements do not satisfy the business connection requirement for accountable plans. Under the

regulations, if a reimbursement arrangement meets the requirements of business connection, substantiation, and returning amounts in excess of substantiated expenses, all amounts paid under the arrangement are treated as paid under an accountable plan. Amounts treated as paid under an accountable plan are excluded from an employee's gross income. The regulations also provide that the business connection requirement will not be satisfied if an employer pays an amount to an employee regardless of whether the employee incurs, or is reasonably expected to incur, deductible business expenses. The IRS guidance describes four examples of expense reimbursement arrangements. The first three examples in the Revenue Ruling are not considered nontaxable reimbursements because the amount being paid is a substitute for an amount that would otherwise be paid as wages. In other words, the employees will get paid the same amount regardless of the amount of expenses they incur. The fourth example, however, is considered to provide nontaxable wages under an accountable plan because the reimbursements are not in lieu of wages that the employee would otherwise be entitled to receive. (Revenue Ruling 2012-25)

CASES

Stock Drop Case Updates

Recent litigation involving claims for breach of fiduciary duties in connection with the offer of employer stock as a retirement plan investment option produced mixed results and reflects a developing split in the federal circuit courts. In the Second Circuit, the Court of Appeals recently affirmed a decision to dismiss claims that the investment committees of two retirement savings plans and their members had breached their fiduciary duties of prudence and loyalty in communication by retaining employer stock as an investment option. Because the terms of the retirement savings plans strongly favor an investment option in employer stock, the court held that plaintiffs must plausibly plead the employer faced a "dire situation" to state a claim that plan fiduciaries abused their discretion in continuing to offer the employer stock fund as an investment and in failing to liquidate employer stock already held. The court held that plaintiffs in the case failed to meet that burden, notwithstanding the plaintiffs' allegations of mismanagement leading to criminal prosecutions, civil settlements, fines, and a 30 percent drop in the value of employer stock. The presumption of prudence does not require the employer stock to have performed optimally. The dismissal of the claim for breached duty of loyalty in communication was also affirmed because the communications cited by the plaintiffs, including certain SEC filings incorporated into the summary plan descriptions (SPDs), were not made by the plan sponsor "in its capacity as plan administrator," and thus were not actionable as misstatements under ERISA. (*In re Glaxosmithkline ERISA Litigation*; 2d Cir. 2012)

In the Sixth Circuit, the Court of Appeals recently reached a decidedly different conclusion when it reversed a decision at the federal trial court level to dismiss a claim for breach of fiduciary duties when the fiduciaries of a 401(k) plan with an employee stock ownership plan (ESOP) component continued to invest in and hold employer stock despite the stock's precipitous decline in value. In essence, the Sixth Circuit reaffirmed its stance that the presumption of prudence does not apply at the motion to dismiss stage. Without the presumption of prudence, the court was left to decide whether the plaintiffs were successful in pleading (i) facts that plausibly allege a fiduciary breached its fiduciary duty and (ii) a causal connection between that breach and the losses suffered by the plan. Here, the court found that the burden was satisfied by the plaintiffs' allegations that the plan sponsor engaged in lending practices that were equivalent to participation in the

subprime lending market, that defendants were aware of the risks of those investments, and that those risks made employer stock an imprudent investment, as evidenced by an alleged 74 percent drop in the price of employer stock. The dismissal of the claim for breach duty of loyalty in communication was also reversed. The court ruled that the plaintiffs' complaint plausibly alleges defendants breached their fiduciary duties by intentionally incorporating the employer's SEC filings into the plan's SPD, thereby conveying misleading information to plan participants. The court held the SPD is a fiduciary communication to plan participants, and selecting the information to convey through the SPD is a fiduciary activity. (*Dudenhoefer v. Fifth Third Bancorp*; 6th Cir. 2012)

Plan Not Required to Restore 401(k) Funds Fraudulently Withdrawn by Ex-Wife

Confirming for plan sponsors the importance of maintaining and following plan procedures, the U.S. Court of Appeals for the Tenth Circuit upheld a 2010 decision by an Oklahoma district court that a 401(k) plan administrator did not abuse his discretion in deciding that a company 401(k) plan should not reimburse a participant for funds fraudulently withdrawn from his account by the participant's ex-wife. We first reported on this case in the November 2010 Employee Benefits Developments. The case involves a former employee who failed to notify his 401(k) plan administrator of his new address following his divorce. As a result, the plan mailed to his marital address confidential instructions on how to access his account electronically. The participant's ex-wife used the information to change the participant's user ID and password and to subsequently withdraw all of the funds in the account. When the participant later discovered the withdrawals, he demanded that the plan restore the lost funds.

The plan administrator denied the claim on the grounds that proper security measures were in place, that the benefits were paid in accordance with plan terms and requirements, and that the loss of benefits was due to the participant's own failure to comply with the address change requirements and to the fraudulent conduct of his ex-wife. The district court agreed with the plan administrator, finding that plan procedures obligating participants to provide updated mailing addresses and informing them that confidential account information would be sent to the addresses on file were clear and were followed. In its review of the plan administrator's decision, the appeals court also agreed, finding that the plan administrator followed established procedures in making disbursement from the participant's account and that the participant was fully informed of those procedures.

The appeals court also denied the participant's claim that, because he personally never received his money, the plan violated the nonforfeiture provisions of ERISA. Finding that a nonforfeitable benefit is not the same as a guaranteed benefit, the court agreed with the lower court that the mere fact that the participant did not receive his benefits is "insufficient in itself to allow him recovery against the plan." (*Foster v. PPG Industries Inc*.; 10th Cir. 2012)

Seventh Circuit Holds ERISA's Anti-Retaliation Provision Covers Informal Complaints

ERISA Section 510 makes it unlawful to take retaliatory action "against a person because he has given information or has testified or is about to testify in any inquiry or proceeding relating to" ERISA. At issue in a recent case was whether ERISA Section 510 applies to unsolicited informal complaints by an employee.

Victor George was a vice president of Junior Achievement of Central Indiana, Inc. In the summer of 2009, George discovered that amounts being withheld from his pay were not being deposited into his 401(k) and health savings accounts. George lodged several complaints with Junior Achievement's accountants, officers, and board members. He also contacted the Department of Labor but declined to file a written complaint. In October 2009, Junior Achievement issued checks to George to make up for the missed deposits plus interest.

George had an employment agreement with Junior Achievement that ran until June 30, 2010. In late 2009, though, George discussed with Junior Achievement's president and chief executive officer, among others, the possibility of retiring in April 2010. On January 4, 2010, Junior Achievement's president and chief executive officer instructed George not to report to work the following day. George brought suit, alleging that Junior Achievement fired him for giving information in an inquiry regarding Junior Achievement's failure to remit amounts withheld from his paycheck to the 401(k) plan and health savings account.

Junior Achievement argued that the term "inquiry" in ERISA Section 510 does not apply to unsolicited informal complaints such as those lodged by George; rather, it applies only to a formal inquiry such as a Department of Labor investigation. The court disagreed with Junior Achievement. Noting that the provision in ERISA Section 510 is "a mess of unpunctuated conjunctions and prepositions," the court explained that when confronted with an ambiguous anti-retaliation provision, any ambiguity is resolved in favor of the employee. As such, the term inquiry should be construed to include an informal question, whether that question is being asked or answered by the employee.

As a result, the court held that ERISA Section 510 guards against retaliatory actions taken because of an informal unsolicited complaint relating to ERISA that is submitted by an employee. The court did not decide the issue of whether George's complaints were the cause of his firing by Junior Achievement. The Seventh Circuit's decision creates a split in the circuits, with the Second, Third, and Fourth Circuits holding that an inquiry requires a formal proceeding (although the courts disagree on the level of formality required), while the Fifth and Ninth Circuits previously held that Section 510 applies to unsolicited informal complaints.

Even though the Department of Labor submitted an amicus brief in support of George's position, no clue is offered as to what, if any, enforcement action was taken by the department relating to Junior Achievement's breach of fiduciary duty in failing to remit employee deferrals to the 401(k) plan and health savings account. (*George v. Junior Achievement of Cent. Indiana, Inc.*; 7th Cir., 2012)

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