EMPLOYEE BENEFITS DEVELOPMENTS MAY 2012

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Practices & Industries

Employee Benefits

RULINGS, OPINIONS, ETC.

IRS to Examine 401(k) Safe Harbor Plans

On the heels of a 2010 401(k) compliance check questionnaire, in response to which as many as 43 percent of responding plan sponsors reported that their plans were safe harbor plans, the IRS has launched an examination project targeting 401(k) safe harbor plans. Although not limited solely to examining compliance with the safe harbor rules, compliance with those rules will be at the forefront of the IRS's review.

Safe harbor 401(k) plans come in two varieties:

1. A plan may provide that the employer will make a matching contribution equal to (i) 100 percent of an employee's elective deferrals, up to three percent of the employee's compensation, and (ii) 50 percent of an employee's elective contributions that exceed three percent of his compensation, but do not exceed five percent of the employee's compensation.

2. A plan may provide that the employer will make a non-elective contribution equal to at least three percent of an employee's compensation.

A 401(k) plan that is not a safe harbor plan must pass certain nondiscrimination testing requirements. IRS regulations stipulate that a plan that provides for a safe harbor matching contribution or a safe harbor non-elective contribution may not use the nondiscrimination test if the safe harbor is not met. Accordingly, plan sponsors who have failed to make required safe harbor contributions may wish to examine their options under the IRS's employee plans compliance resolution system program (otherwise known as the EPCRS program), as the costs of correction may be significantly greater if the failure is discovered by the IRS during an audit.

CASES

Court of Appeals Holds That Union May Be Required to Reimburse Employer for Withdrawal Liability Associated With Multiemployer Plan

The U.S. Court of Appeals for the Sixth Circuit has held that a provision in a collective bargaining agreement (CBA) requiring the union to indemnify the employer for any withdrawal liability resulting from the employer withdrawing from a multiemployer plan was enforceable.

During collective bargaining negotiations, the union in question disclaimed further representation of the employer's employees. As a result, the employer withdrew from the multiemployer plan, participation in which had been required under the CBA. The pension fund, following the employer's withdrawal, imposed withdrawal liability against the employer and assessed $57,291.50, for which the employer sought indemnification from the union.

The union argued that the subject provision in the CBA violated a prohibition in the Employee Retirement Income Security Act of 1974 (ERISA) against an agreement relieving a fiduciary from liability for a breach of his fiduciary. The Sixth Circuit disagreed. It noted that nothing in the CBA relieved the employer of the withdrawal liability. Instead, the indemnification provision was akin to a fiduciary contracting for insurance, which is expressly permitted under ERISA. Accordingly, the Sixth Circuit held that the union was required to indemnify the employer for the $57,291.50 withdrawal liability amount. (*Shelter Distrib., Inc. v. Gen. Drivers, Warehousemen & Helpers Local Union No. 89*, 6th Cir. 2012)

PBGC Asserts Liability Against Foreign Control Group Member

Under the Employee Retirement Income Security Act of 1974 (ERISA), members of a control group of entities are jointly and severally liable for certain liabilities related to underfunded defined benefit plans. This liability arises under ERISA and goes far beyond general principles extending liability based on theories of "alter ego" or "piercing the corporate veil." How these rules apply to entities that are located outside of the United States has not been well settled.

There is nothing in the control group rules of ERISA that would explicitly exclude a foreign entity from being a member of the control group. Several times in the past, the Pension Benefit Guaranty Corporation (PBGC) has tried to proceed against a foreign entity in a U.S. court, but the actions were dismissed because the courts found that they did not have jurisdiction over the foreign entity.

Asahi Tec Corporation, a Japanese corporation, had acquired Metaldyn Corporation in 2007. The PBGC alleged that as part of Asahi's due diligence in the acquisition, Asahi learned about the underfunding in Metaldyne's defined benefit plan and about Asahi's potential liability as a member of the control group.

The U.S. District Court for the District of Columbia found that Asahi was subject to specific jurisdiction within the United States because of the act by which it acquired Metaldyne knowing of the pension liability. The district court did not find that it had jurisdiction over Asahi because of any actions with respect to the operation or termination of the pension plan. Rather, it focused solely on and found jurisdiction arising from Asahi's knowing acquisition of a U.S. corporation and the potential liability it had brought along with it.

While this victory for the PBGC is procedural in nature, it is important in that Asahi may ultimately be found jointly and severally liable for the liability merely because of its ownership of Metaldyne.

It should be noted that the PBGC has, at times, tried to proceed in foreign jurisdictions to assert liability. As of this time, none of those actions have gone as far as a determination by a foreign court of the rights and powers of the PBGC outside of the United States.

Given the huge liabilities being faced by the PBGC with respect to underfunded defined benefit plans, we can expect the PBGC to continue to take actions with respect to foreign entities and to pursue liability under control group theory. (*Pension Benefit Guaranty Corporation v. Asahi Tec Corp.*, D.D.C., 2012)

Acquired Employees Were Properly Denied Shutdown Benefits

Acquisitions and the offer of transition benefits for acquired employees under a seller's plans can be tricky. If those benefits are not structured carefully, protracted litigation can result. A group of former employees, who were transferred to Siemens by Westinghouse as part of a 1998 business unit acquisition, sued Siemens and its retirement plans, alleging that those entities violated the Employee Retirement Income Security Act of 1974 (ERISA) by refusing to provide the employees with permanent job separation pension (PJS) benefits when Siemens terminated their employment.

Under the Westinghouse pension plan, participants who satisfied certain age and service requirements but did not qualify for normal retirement benefits, and who were terminated by the employer because of job movement or product line relocation or location closedown, were entitled to PJS benefits. For this purpose, the plan's definition of employer did not include any future employer (e.g., Siemens) of Westinghouse employees. Notably, the Westinghouse plan did not provide PJS benefits to an employee offered employment by a successor to Westinghouse, or by reason of a separation after August 31, 1998.

Under the purchase agreement between Siemens and Westinghouse, Siemens hired all affected Westinghouse employees. The purchase agreement also required Siemens to establish a defined benefit pension plan for the acquired employees that contained terms and conditions that are "substantially identical" to those of the Westinghouse pension plan in effect as of the closing date, and to provide "compensation and benefit plans and arrangements, which in the aggregate are comparable" to those of the Westinghouse plan as of the closing date. Accordingly, effective September 1, 1998, Siemens adopted separate but virtually identical defined benefit pension plan program for the acquired employees. The Siemens pension plan program did not contain provisions for PJS benefits.

While the general closing date under the purchase agreement was August 19, 1998, the closing date was deemed to be September 1, 1998 for pension and benefits purposes. In the purchase agreement, even though Siemens would become their employer as of August 19, Westinghouse agreed to amend the Westinghouse pension plan to provide the acquired employees with transition benefits in the form of credit for service and compensation for the 13-day period from August 19 through August 31.

In 1999, Siemens closed certain facilities it acquired from Westinghouse and consequently terminated the employment of numerous acquired employees. Upon their termination, 207 of the 227 plaintiffs in this case signed severance agreements releasing Siemens from liability and promising not to sue it for any claims related to or arising out of their employment or termination. Notwithstanding having executed these releases, in March 2002, plaintiffs submitted claims to the Siemens plans for PJS benefits, but the Siemens plans' administrative committees denied those claims on the ground that neither of the Siemens plans provided for PJS benefits. The plaintiffs then sued Siemens and the Siemens pension plans for violations of ERISA.

The federal trial court that heard the case concluded the successor was required to offer the PJS benefits on the basis of two independent theories. First, Siemens created an ERISA transition plan for the acquired employees through the extension of the Westinghouse plan from August 19 to August 31, 1998. The court also concluded that adoption of the Siemens plans pursuant to the terms of the purchase agreement functioned as an amendment of the ERISA transition plan, and that amendment eliminated the acquired employees' PJS benefits in violation of ERISA's anti-cutback provisions. Second, the court determined that Westinghouse transferred to Siemens through the purchase agreement a portion of the Westinghouse plan's liabilities, thereby triggering ERISA's provisions that require the Siemens plans to "provide equal or greater benefits" than those of the Westinghouse plan. The court also concluded that PJS benefits under the Westinghouse plan are protected from cutback under ERISA.

The U.S. Court of Appeals for the Third Circuit disagreed and ruled that none of the acquired employees were entitled to the PJS benefits. With regard to the federal trial court's first theory, the Third Circuit concluded that Siemens did not establish an ERISA transition plan by virtue of the 13-day arrangement, because that arrangement did not require Siemens to perform the administrative undertaking that is the hallmark of an ERISA plan. The plan for the 13-day period was the Westinghouse plan, which Westinghouse sponsored, funded, operated, and administered. Thus, the later adoption of the Siemens plans, which lacked PJS benefits, could not constitute an "amendment" of a transition plan in violation of ERISA's anti-cutback provisions, given that Siemens had not established any plan to amend.

With respect to the federal trial court's second theory, the Third Circuit concluded that because the plaintiffs had not satisfied the conditions for PJS benefits upon a hypothetical termination just prior to Westinghouse's transfer of liabilities to Siemens and could not satisfy in the future the conditions for those benefits, ERISA did not protect those benefits from cutback, and the plaintiffs' benefits would not have included PJS benefits upon the Westinghouse plan's hypothetical termination. Consequently, Siemens' omission of PJS benefits from its plans and the plaintiffs' resulting lack of entitlement to PJS benefits under the Siemens plans upon a hypothetical termination basis following the transfer of liabilities did not diminish the plaintiffs' benefits in violation of ERISA. (*Shaver v. Siemens Corporation*, 3rd Cir. 2012)

Employer Is Not Liable for Allegedly Ambiguous Summary Plan Description

In *Skinner v. Northrop Grumman Retirement Plan B*, the U.S. Court of Appeals for the Ninth Circuit, applying the Supreme Court's ruling in *CIGNA Corp. v. Amara*, held that the plaintiff-participants could not sue for benefits allegedly promised by the summary plan description (SPD) but not the plan, because statements in an SPD do not constitute the terms of a plan.

The Ninth Circuit also held that the plaintiff-participants were not entitled to additional benefits based on the equitable remedies of estoppel, reformation, and surcharge, even if, as the plaintiffs alleged, the SPD did not accurately and completely communicate plan benefits. The court's rulings with respect to the equitable remedies of estoppel, reformation, and surcharge are particularly noteworthy.

Estoppel. Under an estoppel theory, a court can order a plan to pay benefits not provided under the terms of the plan where a participant is able to establish that he or she detrimentally relied on conflicting statements in an SPD. In some circuits, like the Second Circuit, a plaintiff is not required to establish detrimental reliance (i.e., that he or she had actually read the SPD and that, but for the accurate description, would have acted differently) as long as the participant can show that a plan participant or beneficiary was likely to have been harmed as a result of the deficient SPD. The plaintiffs in *Skinner* admitted that they could not offer evidence that they relied to their detriment on the SPD and did not otherwise pursue an estoppel claim. The question that remains is whether the Ninth Circuit in *Skinner* can be said to have ruled out the notion that an equitable estoppel claim could proceed without evidence of actual reliance.

Reformation. Under the equitable remedy of reformation, a court could, under the right circumstances, order an employer to reform (i.e., amend) the terms of a plan document to match the terms of an SPD that contains a benefit promise not documented as part of the plan.

The plaintiffs in *Skinner* asked the Ninth Circuit to so rule, but the Ninth Circuit declined to do so on the basis that reformation is not appropriate absent fraud or mistake. The Ninth Circuit held that the plaintiffs had presented no evidence of fraud or mistake in documenting the terms of the plan.

Surcharge. Under the equitable remedy of surcharge, a fiduciary could be "surcharged" for benefits gained through unjust enrichment or for harm caused by the fiduciary's breach of duty. In this respect, the court held that even if the SPD was faulty, surcharge would not be an appropriate remedy in this case because there was no evidence that the plan's administrative committee was unjustly enriched as a result of the allegedly faulty SPD, nor was there evidence that the plaintiffs were harmed by the statements in the SPD. In so ruling, the court rejected the plaintiffs' argument, which was based on the majority opinion in Amara, that the "harm" sustained was the harm of being statutorily deprived of their statutory right to an accurate SPD.

The Lesson of Skinner

While plan sponsors and fiduciaries can take some comfort in the ruling, we must continue to emphasize the importance of paying careful attention when drafting plan documents and SPDs to ensure that the plan and SPD present consistent information. (Skinner v. Northrop Grumman Retirement Plan B, 9th Cir. 2012)
(*Skinner v. Northrop Grumman Retirement Plan B*, 9th Cir. 2012)

Separation Policy Benefit Is Not an "Early Retirement Subsidy" Subject to QDRO

The U.S. District Court for the Eastern District of Pennsylvania recently ruled that a retirement subsidy to a terminated employee provided under a separation policy is not subject to division under a qualified domestic relations order (QDRO) prepared in connection with the employee's 2005 divorce. The QDRO designates the employee's ex-wife as an alternate payee and awards her 53 percent of the present value of the participant's accrued benefit in a defined benefit pension plan. Under the QDRO, if the alternate payee commences benefits before the participant retires, her payment is limited to the actuarial value of the normal retirement benefit accrued as of December 20, 2004. However, if the participant subsequently retires before age 65, the QDRO provides that the alternate payee's benefit will be "recalculated to include 53 percent of the value of any employer subsidy for early retirement."

In this case, the alternate payee elected to begin receiving benefits before the participant retired. In accordance with the QDRO, her benefit was limited to 53 percent of the normal retirement benefit accrued by the participant as of December 20, 2004. In 2009, at the age of 57, the participant was terminated because of a reduction in force, and he began receiving retirement benefits. The participant also received two additional benefits: an early retirement subsidy for retirees with twenty years of service and a benefit under a separation policy that provides fully subsidized retirement benefits to employees who are at least 55 and who are terminated under certain conditions. Although the first early retirement subsidy was divided under the QDRO, the plan determined that the alternate payee was not entitled to the benefit provided under the separation policy. The alternate payee sued the employer, arguing that the separation policy benefit is subject to the QDRO because it was an "accrued benefit"
as of December 20, 2004, and is a "subsidy for early retirement." The district court disagreed. Pointing to the definition of "accrued benefits" in Section 3(23) of the Employee Retirement Income Security Act of 1974 (ERISA), the district court determined that the separation policy benefit is not an accrued benefit under ERISA because it does not accumulate over time and is not expressed as a benefit commencing at normal retirement age. The district court also rejected the alternate payee's claim that the separation policy benefit is a "subsidy for early retirement." The district court found that the separation policy subsidy is not provided "for" or "on account of" early retirement. Rather, it is provided because a participant is being terminated by the company for a specific qualifying reason related to organizational restructuring and only in conjunction with a signed separation agreement and a release of claims. The court concluded that the benefit is provided "for reasons entirely separate from early retirement" and is therefore not a "subsidy for early retirement" subject to division under the QDRO." (*Gruber .v PPL Retirement Plan*, E.D. Pa. 2012)

Estate May Sue to Enforce Waiver and Recover 401(k) Benefits

Although a deceased participant's benefit in a 401(k) plan must be distributed to an ex-wife despite a prior waiver of her rights to the benefit, the U.S. Court of Appeals for the Third Circuit ruled that the participant's estate may subsequently sue the ex-wife for recovery of the distributions. The ex-wife in this case waived her right to the proceeds of the decedent's 401(k) plan upon their divorce in 2003. In a scenario that occurs often, the participant neglected to replace his ex-wife as designated beneficiary of the 401(k) benefit following their divorce. On the participant's death nine months later, both the participant's estate and the ex-wife claimed a right to the plan proceeds. Following U.S. Supreme Court precedent in *Kennedy v. Plan Administrator for DuPont Savings and Investment Plan* (2009), a lower court determined that the plan administrator must act in accordance with the plan documents and instruments when paying benefits and must therefore distribute the 401(k) benefit to the ex-wife. This conclusion was not challenged on appeal and was upheld by the U.S. Court of Appeals for the Third Circuit.

However, the Third Circuit disagreed with the lower court's conclusion that the estate could not sue the ex-wife directly under contract law to enforce her waiver and recover the benefits. The lower court reasoned that allowing the estate to sue the ex-wife would undermine one of the principal objectives of Employee Retirement Income Security Act of 1974 (ERISA)—namely, that "named beneficiaries actually receive the benefits of ERISA-governed plans."

Distinguishing this case from prior cases where plan administrators had not yet distributed benefits, the Third Circuit found no impediment to permitting a lawsuit to enforce the common law waiver after the benefits have been paid to the ex-wife. As the court reasoned, "permitting suits against beneficiaries after benefits have been paid does not implicate any concern of expeditious payment or undermine any core objective of ERISA." (*Estate of Kensinger v. URL Pharma Inc.*, 3rd Cir. 2012)

Release Protects TPA From Negligent Misrepresentation Claim

The U.S. District Court for the Middle District of Tennessee dismissed a retired employee's negligent misrepresentation claim against a third party administrator (TPA) who provided services to his former employer's Supplemental Executive Retirement Plan (SERP).

While still employed, the employee, a participant in the SERP, had received a benefit statement from the TPA indicating that he had an accrued $1,234,572 as of January 1, 2008. The employee claims that, in reliance on this benefit statement, he elected be included in the employer's reduction in force. As part of his termination of employment, the employee signed a separation agreement that included a release of any claims against the employer and its agents. The TPA subsequently sent a letter to the employer, which was then shared with the employee, stating that the employee's estimated retirement benefit was $517,103.10 (assuming a termination date of November 15, 2008). The TPA explained that the prior benefit statement valued the benefit based on the assumption that the employee would retire at normal retirement age of 62.

The employee brought a negligent misrepresentation claim against the TPA, arguing that the separation agreement contained an exception from the release for all rights and benefits under any employment benefit plan, including the SERP. The district court disagreed, however, reasoning that because the employee was not seeking benefits in accordance with the written terms of the SERP plan, his claim was not subject to the exception. Rather, the negligent misrepresentation claim is a state law tort claim that is clearly barred by the release in the separation agreement that the employee signed. (*Duncan v. Milliman Inc.*, M.D. Tenn. 2012)

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