EMPLOYEE BENEFITS DEVELOPMENTS AUGUST 2011

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Practices & Industries

Employee Benefits

RULINGS, OPINIONS, ETC.

PBGC Finalizes Rules for Bankruptcy Termination Date

Under the Pension Protection Act of 2006, the Employee Retirement Income Security Act of 1974 (ERISA) was amended to provide that the date a plan sponsor files a bankruptcy petition will be treated as the termination date when a defined benefit plan is terminated in bankruptcy. The Pension Benefit Guaranty Corporation (PBGC) has finalized regulations implementing this provision and expects that, in many cases, the change in the law, as reflected in the final regulations, will reduce the amount of guaranteed benefits under the plan payable by the PBGC and the amount of benefits in priority category three in determining benefits payable under the PBGC insurance program. Some highlights of the effects of this final regulation are:

- The benefit guaranteed by the PBGC will be based on the amounts of service and the amount of compensation as of the bankruptcy filing date.
- The ERISA Title IV limit on the amount of guaranteed benefits will be determined as of the bankruptcy filing date.
- Nonforfeitable benefits will be determined as of the filing date. Early retirement subsidies and disability benefits to which a participant becomes entitled to after the bankruptcy filing date will not be guaranteed. Individuals who receive their subsidized early retirement benefits to which they first become entitled after the bankruptcy filing date will continue to receive payments, but the amount of the benefits will be reduced to reflect that the subsidy or benefit is not guaranteed.
- If the plan has more than one contributing employer and the employers did not file for bankruptcy on the same date, the PBGC will use facts and circumstances to determine the date of termination.

These regulations are applicable to bankruptcy proceedings filed on or after September 16, 2006. (76 Fed. Reg. 34590)

New York State Recognizes Same-Sex Marriages

New York State became the sixth and largest state to legalize same-sex marriages when it passed the Marriage Equality Act (Act) on June 24, 2011. In 2008, New York began recognizing same-sex marriages that were legally performed in other jurisdictions. However, it was not until the Act became effective on July 24, 2011 (30 days after Governor Cuomo signed it into law), that same-sex couples could obtain marriage licenses in New York State. The Act states: "[n]o government treatment or legal status, effect, right, benefit, privilege, protection or responsibility relating to marriage, whether deriving from statute, administrative or court rule, public policy, common law or any other source of law, shall differ based on the parties to the marriage being or having been of the same-sex rather than a different sex." The recognition of same-sex marriages will impact employers in New York State that extend benefits to employees' spouses. However, the specific impact will depend on the type of employer and the specific type of benefit plan.

ERISA Plans vs. Non-ERISA Plans. Most private sector employers' plans are subject to ERISA, which, as a federal law, generally preempts state law as it relates to employee benefit plans. Therefore, a plan (such as a medical plan) that is subject to ERISA would not be required to follow the Act and would not be required to recognize same-sex spouses for purposes of providing coverage. It should be noted, however, that a plan subject to ERISA could provide such coverage, so long as the term "spouse" was defined to include same-sex spouses. To avoid any ambiguity (and potential lawsuits), employers with plans subject to ERISA should clearly define the term "spouse" as it relates to their plans.

In contrast, church plans and government plans (such as plans sponsored by school districts or municipalities) are not subject to ERISA and are subject to state law. As such, government and church plans are generally required to recognize same-sex spouses for purposes of eligibility for their plans that provide coverage to spouses.

Insured vs. Self-Insured Plans. ERISA also does not preempt state insurance law. Therefore, insurance policies issued in New York State are subject to the Act and are required to recognize same-sex spouses. As a result, if an employer, including an employer subject to ERISA, has a plan that is insured by a policy issued in New York State, that policy is required to recognize same-sex spouses for purposes of coverage.

DOMA and the Code. In addition to the type of employer, the impact of the Act will also depend on the type of plan. The Defense of Marriage Act (DOMA), enacted in 1996, requires all federal laws and regulations that use the term spouse or marriage limit the definition of those terms to mean a marriage between one man and one woman. Because the Internal Revenue Code (IRC), a federal law, uses the term "spouse," such references do not include a same-sex spouse. As a result, retirement plan spousal benefits that are derived from the IRC, such as Qualified Joint and Survivor Annuities (QJSAs) and Qualified Pre-Retirement Survivor Annuities (QPSAs), will not automatically apply to same-sex spouses. Also, so-called Code Section 105(h) plans, such as health flexible spending accounts, cannot reimburse medical expenses incurred by a same-sex spouse, unless the same-sex spouse otherwise qualifies as the employee participant's tax dependent.

State vs. Federal Income Tax. Because the IRC does not recognize same-sex spouses, the value of employer provided coverage provided to a non-dependent same-sex spouse will be considered taxable income to the participant for federal income tax purposes. However, because the Act requires recognition of same-sex spouses for all state purposes, the value of the employer provided coverage will not be subject to New York State income tax.

Because of the interplay between ERISA, DOMA, and the Act, employers must carefully review their plans that offer benefits to spouses to determine which definition of spouse can or, in some cases, must apply in each situation. The definition of spouse that is used should be clearly defined and communicated to plan participants. The availability of coverage should be coordinated with the plan's insurer or stop-loss carrier. Finally, the employer's payroll department or third party administrator should be alerted to the complex tax treatment of coverage provided to same-sex spouses.

CASES

Post Bankruptcy Petition Withdrawal Liability Treated as Administrative Expense for Priority Purposes

In what is described as a case of first impression, the U.S. Court of Appeals for the Third Circuit has determined that the portion of an employer’s withdrawal liability that is attributable to the period after the date of the petition for bankruptcy is an administrative expense and entitled to priority under bankruptcy law. In the particular case, the employer filed for Chapter 11 bankruptcy protection on November 30, 2006. The employer participated in a multiemployer defined benefit plan. On May 30, 2008, the debtor sold its assets and ceased to employ any of the covered employees. As a result of the cessation of obligation to contribute to the multiemployer plan, a claim for the complete withdrawal liability in the amount of approximately $5.9 million was filed. The multiemployer plan asserted that the full withdrawal liability was entitled to administrative expense. The bankruptcy court initially classified the entire claim as a general unsecured claim. In a subsequent decision, the district court reversed the bankruptcy court and divided the withdrawal liability into pre- and post-petition amounts. This allowed a portion of the withdrawal liability to be given preference as an administrative expense. The Third Circuit upheld the lower court decision and found that withdrawal liability may be apportioned into the pre-petition as well as the post-petition period and the amount attributable to the post-petition period is an administrative expense claim under the bankruptcy code. The court found that the debtor corporation or debtor employer benefited from the post-petition services performed by employees and therefore this constituted a post-petition administrator expense. The Third Circuit’s decision is the first Court of Appeals decision to apply this apportionment approach. It is important to note that the Third Circuit includes Delaware where many bankruptcy cases are filed. Therefore, those involved in bankruptcy cases filed in Delaware, or elsewhere within the Third Circuit, should consider the effect of this apportionment between pre- and post-petition withdrawal liability. (*In re: Marcal Paper Mills Inc*., 3rd Cir. 2011)

Discounted Telephone Benefits for Retirees Do Not Constitute an ERISA Pension Plan

Telephone company employees filed a lawsuit asserting that the telephone company’s practice of reimbursing those retirees who live outside of the employees’ service area for their telephone expenses constituted a defined benefit pension plan and that telephone company failed to follow ERISA regulations for pension plans, including those related to funding, vesting, and disclosure requirements. At the federal district court level, the court granted summary judgment to the telephone company, concluding that the telephone company's practice of offering discounted telephone services to employees and retirees is not a pension plan, in whole or in part. The case was appealed, and the Fifth Circuit Court of Appeals recently affirmed the judgment of the district court. The parties agreed the telephone benefits did not constitute a welfare plan. Therefore, the only question for the Fifth Circuit to decide was whether the telephone benefit, in part or in whole, is a pension plan. In affirming the decision of the district court, the Fifth Circuit, among other things, rejected the employees' argument that the telephone benefit is a pension plan under ERISA because it "provides retirement income." To provide retirement income for ERISA purposes, a plan must be designed for the purpose of providing retirement income. In this case, the Fifth Circuit concluded that although the telephone benefit does provide taxable income to some out-of-region retirees, that income is *incidental* to the benefit. The "primary thrust" of the telephone benefit is to provide retirees with discounted phone service, which a vast majority of the beneficiaries received as a no-additional-cost service. The Fifth Circuit also rejected the employees' argument that the telephone benefit, when viewed as to all retirees, results from a deferral of income. To show that the telephone benefit results from deferred income, the Fifth Circuit ruled that the employees had to show they forewent income at some point in exchange for receiving income from concession at a later date, which the court ruled they failed to do. (*Boos v. AT&T Incorporated*, 5th Cir. 2011)

Important to Follow Proper Plan Amendment Procedures

A recent court decision reminds us how important it can be to follow procedures specified in plan documents when adopting plan amendments. A federal district court in North Carolina recently ruled an amendment to an employer's retirement plan authorizing the liquidation of company stock from the plan was invalid. Because the plan document specifically identified company stock as an available investment option, a plan amendment was required to authorize the stock's liquidation. The plan's amendment procedures required action (either by a majority vote or by a written instrument signed by a majority of the committee members) by the plan committee to adopt any plan amendment. The committee did not meet to consider the amendment, and only the committee secretary's signature appeared on the amendment eliminating company stock as an investment option, thus rendering the amendment ineffective. It is worth noting that this decision was made in the context of a class action lawsuit to recover plan losses alleged to have resulted from the liquidation of the company stock. (*Tatum v. R.J. Reynolds Tobacco Co.*, M.D.N.C. 2011)

Is PPACA Constitutional?

On August 12, 2011, in *State of Florida v. United States Department of Health and Human Services*, the Court of Appeals for the Eleventh Circuit held that the provision in the Patient Protection and Affordable Care Act (PPACA) that requires individuals to buy health insurance or pay a tax penalty (the so-called "individual mandate") is unconstitutional. In so ruling, the Eleventh Circuit stated that the federal government cannot mandate "that individuals enter into contracts with private insurance companies for the purchase of an expensive product from the time they are born until the time they die." The Eleventh Circuit's decision is in conflict with a ruling handed down in June 2011 by the Court of Appeals for the Sixth Circuit in *Thomas More Law Center v. Obama*, which upheld the constitutionality of the mandate.

Now that two of the highest courts in the land have reached contrary decisions on the matter, the case is poised for review by the United States Supreme Court. However, the conflict between the circuits does not ensure that the Supreme Court will review the matter; the Supreme Court has the discretion to decide which cases it will hear. Some prominent court watchers predict the Supreme Court will delay consideration of the constitutionality of the individual mandate until other appeals courts have had a chance to render an opinion.

Importantly, the Eleventh Circuit did not declare the entire health care reform law unconstitutional. The court disagreed with the plaintiffs, which included 26 states, two individuals and the National Federation of Independent Business, who argued that because the mandate is so integral to PPACA, the entire law should be declared unconstitutional if the court should rule that the individual mandate is unconstitutional. If the Eleventh Circuit's analysis gains traction, popular provisions (like the age-26 dependent coverage mandate and first dollar coverage of preventive care services) will survive future challenges but so will the law's most controversial provisions, such as the so-called employer mandate.

Until the issue is finally resolved through legislative action or Supreme Court decree, plan sponsors should make every effort to comply with PPACA. Some court watchers believe the Supreme Court would uphold the law, but even if the Supreme Court were to rule that the individual mandate is unconstitutional, it could follow the Eleventh Circuit's analysis and uphold the rest of the law. Hopefully, this matter will be decided well in advance of the January 1, 2014 effective date.

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