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EMPLOYEE BENEFITS DEVELOPMENTS OCTOBER 2010

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Practices & Industries

Employee Benefits

RULINGS, OPINIONS, ETC.

Grace Period Provided for Compliance With Health Plan Claims Procedures

Treasury, the Department of Labor, and the Department of Health and Human Services jointly issued a technical release giving group health plans until July 1, 2011, to comply with the new internal claims and appeals procedures required under the Patient Protection and Affordable Care Act (PPACA). Under PPACA, non-grandfathered health plans must make several significant changes to their internal disputed-claims procedures. These changes include:

- Requiring an initial response to an urgent claim within 24 hours
- Providing notices in a culturally and linguistically appropriate manner
- Providing broader content and specificity in denial notices
- Replacing the "substantial compliance" standard for claims review with a "strict liability" standard

Although PPACA requires that these changes be made as of the first day of the plan year beginning on or after September 23, 2010, the agencies stated they will not take any enforcement action during the grace period against any plan that is working in good faith to implement the additional standards. (Technical Release 2010-02)

Mandatory W-2 Reporting of the Cost of Medical Coverage Delayed

Under the PPACA, employers are required to report the cost of employer-sponsored health coverage on their employees' 2011 Forms W-2 (generally issued in early 2012). However, a recent notice provides relief to employers with respect to this reporting requirement. Under the new guidance, this reporting will not be mandatory for Forms W-2 issued for 2011. The delay in the mandatory reporting requirement will give employers an additional year to update their payroll procedures to track the cost of medical coverage. Additional guidance is expected from the Internal Revenue Service (IRS) in the coming year with regard to how the cost of coverage should be calculated. Stay tuned. (IRS Notice 2010-69)

PBGC Proposes Controversial Regulations Regarding Substantial Cessation of Operations

Section 4026(e) of the Employee Retirement Income Security Act of 1974 (ERISA) requires that certain actions must be taken when a defined benefit plan experiences a substantial cessation of operations. If there is a cessation of a business operation and as a result more than 20 percent of the active participants in a defined benefit plan have separated from employment, an ERISA § 6042(e) event occurs. The employer is then required to deposit a calculated amount into an escrow account with the Pension Benefit Guaranty Corporation (PBGC) for five years or obtain a bond in favor of the PBGC for up to 150 percent of the amount for five years. The requirement to post this security is imposed even if there is no intent to terminate the defined benefit plan and even if the plan has satisfied all existing contribution requirements and would otherwise be viewed as well funded.

In recent years, the PBGC has greatly increased its use of ERISA § 4062(e) to obtain additional protections in situations where a substantial cessation of operations has occurred. The PBGC has proposed regulations defining some of the essential terms under the statute. The PBGC said it is proposing these regulations because of numerous inquiries they have received and in order to provide better guidance to plan sponsors. The proposed regulations greatly expand the number of situations in which a substantial cessation of operations would occur. Some comments have been filed with the PBGC indicating that the proposed regulations extend far beyond what is intended under ERISA § 4062(e) and would be disruptive to regular business operations. The PBGC recently indicated that it is extending to November 12, 2010, the period for receiving comments on the proposed regulations.

We will provide further updates when the PBGC takes additional action. In the meantime, sponsors of defined benefit plans that cease operations at a facility, sell subsidiaries, or otherwise reduce the number of active employees covered under a plan should review whether ERISA § 4062(e) may apply and whether notice needs to be given to the PBGC about a potential substantial succession of operations. (75 Fed. Reg. 48283)

CASES

District Court Rules Participant’s Child Is Entitled to Benefits Because Divorce Decree Qualified as a QDRO

The U.S. District Court for the Northern District of Ohio recently ruled that a deceased participant’s daughter was entitled to the entire proceeds of his employer-provided life insurance policy despite the fact that his spouse was named as the primary beneficiary. The participant’s first marriage ended in divorce, and the resulting divorce decree ordered the participant to name his daughter from the marriage as the 100 percent beneficiary of his “life insurance policy plans as available through employment.” The participant later remarried and executed a beneficiary form naming his second wife as the primary beneficiary entitled to 100 percent of the policy proceeds instead. After the participant died, his daughter and second wife filed competing claims to the policy proceeds, and the dispute was brought before the district court. The daughter claimed that she was entitled to the entire policy proceeds on the basis that the divorce decree was a Qualified Domestic Relations Order (QDRO) under ERISA. The district court agreed with the daughter, finding that the divorce decree qualified as a QDRO because it substantially complied with ERISA's QDRO requirements. The district court explained in its decision that where a divorce decree qualifies as a QDRO, it can assign the right to a participant's benefits under a welfare plan such as an employer-provided life insurance policy. Therefore, because the divorce decree in this case qualified as a QDRO, the daughter was entitled to the full policy proceeds even though the participant named his second wife as the primary beneficiary. (*Metropolitan Life Insurance Co. v. Darkow*, N.D. Ohio 2010)

Seventh Circuit Upholds Plan's Determination That Surviving Spouse Did Not Waive Right to Benefits

Prior to his death, a participant in his company's pension plan attempted to name a trust as the primary beneficiary of his benefits under the plan. Under the terms of the plan, the participant was required to obtain his spouse's consent in order to designate a beneficiary other than the spouse. The participant submitted the required beneficiary designation paperwork to the plan, including what appeared to be a validly executed spousal consent form. After the participant died however, the spouse's guardian filed a claim for the benefits. The plan then learned that the participant had the spousal consent form notarized without his spouse being present, making the consent invalid because it was not properly witnessed. The plan also received evidence establishing that at the time she allegedly signed the form, the spouse was not mentally competent to waive her rights and consent to another beneficiary being named. The plan therefore determined that the spouse did not waive her rights, notified the trust of its conclusion that the spouse was the primary beneficiary, and paid the benefits to the spouse.

The trust then sued the plan for failure to pay benefits and breach of fiduciary duty under ERISA. The plan's decision was upheld at the district court level, and the trust argued on appeal to the U.S. Court of Appeals for the Seventh Circuit that the plan breached a fiduciary duty and did not give the trust's claim a "full and fair review" when it denied the trust's claim and paid benefits to the spouse. The Seventh Circuit examined the plan's determination under the deferential arbitrary and capricious standard of review and concluded that the determination was reasonable in light of the evidence regarding the improper execution of the spousal consent form and the spouse's incapacity. The court also found that the trust's claim was given a full and fair review because the plan engaged in a "diligent" investigation and adequately communicated the basis of its determination to the trust. The court would not consider the trust's fiduciary breach claim, explaining that since the trust was seeking monetary damages,
it would have to have been entitled to at least some benefits in order to pursue the claim. In any event, the court noted there was no indication of flawed decision-making on the part of the plan administrator. Accordingly, the court upheld the plan's decision to pay the benefits to the participant's spouse. This case demonstrates the importance of ensuring that all beneficiary designation requirements are properly met and highlights the importance to plan administrators of conducting detailed investigations into competing benefit claims. (*Ponsetti v. GE Pension Plan*, 7th Cir. 2010)

Retroactive Amendment to Nonqualified Plan Upheld

A recent New York federal court decision illustrates the authority an employer can retain to amend material provisions of nonqualified plans in ways that could not be done in a qualified plan. In this case, an employer maintained a nonqualified arrangement for a select group of management employees. The arrangement allowed the covered employees to defer current compensation for later distribution. The deferred amounts were to be credited with growth or earnings based on elections made by the employee. The investment options included interest-bearing accounts, stock accounts, and mutual funds. The nonqualified arrangement maintained a "phantom" account for each employee to which the deferred compensation and earnings were credited. Under the arrangement, the employer reserved the right to amend the plan. The interest-bearing option under the arrangement credited earnings based on a bank prime interest rate. The participant in this case participated in the arrangement beginning in the 1980s. The employer amended the plan in late 2006 to change the basis for crediting interest in the interest-bearing option from the bank prime rate to an applicable federal rate of interest used by the IRS for numerous interest rate adjustments. The new interest rate was to be used beginning in 2007. While participants were permitted to move their accounts in the nonqualified plan before 2007 began, an account that was left in the interest-bearing option would have the new interest rate calculation applied to all the years of the account, including years before and after 2007. The employee in this case had elected the interest-bearing option before 2007 and remained in that option after the change. In the lawsuit, the employee claimed that the employer could not retroactively adjust the interest rate credit for the periods before 2007. Because the employer had effectively reserved the right to amend this nonqualified plan, the court upheld the employer's action and dismissed the employee claim. The lesson is that careful plan drafting can effectively preserve an employer's ability to adjust benefit plans in appropriate circumstances. (*Cram v. PepsiCo Executive Income Deferral Compensation Program*, S.D.N.Y. 2010)

Post-Normal Retirement Date Benefit Accruals

Defined benefit plan administrators can find the rules dealing with benefit accruals and actuarial adjustment after normal retirement date are complex and confusing. Such complexities are featured in a recent case dealing with defined benefit pension plan provisions applied to a participant who continues working beyond the plan's normal retirement date. The plan had been amended over the years, but if the participant continued in employment at the time the participant reached normal retirement age the plan provided that no benefit would be paid. Accruals for additional service would also continue and there would be no actuarial adjustment (increase) for the deferral of retirement benefits beyond normal retirement.

The participant in this case continued to work beyond normal retirement and claimed that the lack of an actuarial increase for deferred retirement violated the statutory rules prohibiting cutbacks in accrued benefits and the forfeiture of vested benefits. The participant also argued alternatively that the plan rules otherwise violated the fiduciary obligations of the plan administrator. While the details of this case are further complicated by the fact that the plan covered airline pilots, whose employment beyond age 60 has been the subject of unique statutory rules, the principal lesson of the case is that defined benefit plan provisions applicable to participants working beyond their normal retirement date require special consideration and attention. This is especially true in current circumstances as older workers often work beyond traditional retirement dates. In this case, the court upheld the plan's rules that suspended benefits until actual retirement while allowing for additional accruals for continued service but no actuarial increase for deferred retirement. For any employer maintaining a defined benefit plan, a careful review of post-normal retirement date rules may be important in dealing with this common situation. (*Canada v. American Airlines, Inc. Pilot Retirement Benefit Program*, M.D. Tenn. 2010)

Plan Sponsor Allowed to Reform Plan to Correct Scrivener's Error

A federal appeals court recently ruled that Verizon Communications should be allowed to reform its cash balance pension plan to fix a scrivener's error that could have cost Verizon $1.67 billion – yes, $1.67 billion. The appeals court held Verizon's claim for equitable relief could succeed only if Verizon presented "clear and convincing evidence" that the plan contains a scrivener's error that does not reflect the participants' reasonable expectation of benefits. That evidence must be objective and not dependent on an interested party.

The case involved a conversion of the value of employees' benefits under an old pension plan to cash balances under a new pension plan. The plan used multipliers to complete the conversion. The plan language unintentionally called for the relevant multiplier to be utilized twice, which would have provided the participants a much greater plan balance than the plan intended. The plaintiff claimed that ERISA requires strict adherence to the plan documents and that the participants were therefore entitled a benefit based on the double multiplier, as provided by the plan terms.

The federal trial court previously concluded the plan's committee abused its discretion by unilaterally disregarding the application of the second multiplier as a drafting mistake. The trial court, however, also granted Verizon's counterclaim for equitable reformation of the plan to remove the second multiplier as a scrivener's error. The appeals court held that Verizon met its burden of proof and affirmed the decision of the federal trial court. (*Young v. Verizon's Bell Atlantic Cash Balance Plan*, 7th Cir. 2010)

ERISA Does Not Protect Employees From Misstatements Involving Non-ERISA Stock Option Plans

A 51-year-old employee terminates her employment. Before leaving, she asks her employer about her eligibility for, and the terms of, various benefits, including an ERISA pension benefit plan and a non-ERISA stock option plan. Under the stock option plan, options terminate when the employee ceases to be an employee "for any reason including retirement," unless the option holder retires or is eligible for retirement under the ERISA pension benefit plan. The employee in this case is not eligible for early retirement under the ERISA pension benefit plan, but she allegedly receives erroneous information from her employer that her stock options will remain exercisable for the remainder of the grant period. Later, the employee is told that some of her stock options, worth millions of dollars, have been or will be cancelled because she is not eligible for retirement under the ERISA pension benefit plan. The employee sues the employer, asserting a breach of ERISA fiduciary duties relating to alleged misstatements regarding her ability to exercise the options.

The federal trial court in this case concluded that any misrepresentations or omissions relied upon by the employee related solely to the stock option plan. Because the stock option plan was a non-ERISA plan, the employer did not breach its ERISA fiduciary duty. The employee appealed and a split federal appeals court affirmed the decision of the federal trial court. (*Bell v. Pfizer Inc*, 2nd Cir. 2010)

Plan Not Required to Rollover Annuity to IRA

A U.S. District Court in Tennessee recently ruled that a retirement plan is not required to roll over a participant's annuity payments into an IRA. In 2008, the plan administrator in this case denied a plan participant's request that his plan balance be rolled over into an IRA. Following exhaustion of his administrative remedies, the participant filed suit in federal court, arguing that the plan permits him to roll his plan balance into an IRA. The court disagreed, noting that, although the plan terms permit a participant to elect to have "an eligible rollover distribution paid directly to an eligible retirement plan," the plan also provides that an "eligible rollover distribution" specifically does not include "any distribution that is one of a series of substantially equal periodic payments . . . made for the life . . . of the participant . . . ." Because the participant was receiving his benefits in the form of a monthly annuity, which did not qualify under the plan as an eligible rollover distribution, the court held that the participant is not entitled to have any portion of the distribution paid into an eligible retirement plan. In reaching its decision, the court dismissed the participant's argument that the plan must provide for a rollover option to qualify as an Internal Revenue Code (IRC) § 401(a) qualified plan. Although IRC §401(a)(31) requires retirement plans to permit rollovers of any lump sum distributions authorized under the plan, the court found that it does not require that a plan distribute benefits in a lump sum so that participants may elect a rollover. The court also dismissed the participant's claims that the denial of rollover permission was motivated by a financial conflict of interest, and, noting that the plan administrator properly followed the plan's claims review procedures, including providing written explanations of its determinations, the court dismissed claims that the determinations were arbitrary and capricious. (*Scheib v. Retirement Program Plan for Employees of Certain Employers at the U.S. Department of Energy Facilities at Oak Ridge, Tenn.*, E.D. Tenn. 2010)

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