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EMPLOYEE BENEFITS DEVELOPMENTS AUGUST 2010

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Employee Benefits

RULINGS, OPINIONS, ETC.

HEALTH CARE REFORM UPDATE

Interim Final Claims and Appeals Rules: Enforcement Safe Harbors and Model Notices

BACKGROUND

In our July 2010 *Employee Benefits Developments* we wrote about the recently issued Interim Final Rules Relating to Internal Claims and Appeals and External Review Processes.

The Interim Final Claims Rules provide standards that *non-grandfathered* group health plans must follow in connection with both internal claims and appeals, and external review of denied claims. The Interim Final Claims Rules also provide a basis for determining when plans must comply with an applicable state external review process and when they must comply with the federal external review process.

For group health plans that are not subject to an existing state external review process (including self-insured plans), a federal process is to apply to *non-grandfathered* group health plans for plan years beginning on or after September 23, 2010 (January 1, 2011, for calendar-year plans).

The preamble to the Interim Final Claims Rules provided that there would be additional guidance on the federal external review process. In Technical Release 2010-01, released August 23, 2010, the U.S. Department of Labor (DOL) provides this guidance.

TECHNICAL RELEASE 2010-01

The technical release provides an interim enforcement safe harbor for non-grandfathered self-insured group health plans that are subject to the federal external review process. Under the interim enforcement safe harbor, the DOL and IRS will not take any enforcement action against a self-insured group health plan that complies with either of the following compliance methods:

The group health plan complies with detailed procedures set forth in the technical release. Affected plans can begin their review of these procedures by accessing the technical release at: http://www.dol.gov/ebsa/pdf/ACATechnicalRelease2010-01.pdf

If a state chooses to extend its state external review process to self-insured plans, the group health plan chooses to voluntarily comply with the provisions of that state external review process.

The interim enforcement safe harbor applies for plan years beginning on or after September 23, 2010. The safe harbor applies until superseded by future guidance to be issued no later than July 1, 2011.

MODEL NOTICES

The preamble to the Interim Final Claims Rules also stated that the agencies would publish model notices that plans could use to satisfy the notice requirements of the Interim Final Claims Rules. These model notices are now posted on the DOL's website at www.dol.gov/ebsa.

The model notices include:

- A notice of adverse benefit determination available at: http://www.dol.gov/ebsa/IABDModelNotice2.doc
- A notice of final internal adverse benefit determination available at: http://www.dol.gov/ebsa/IABDModelNotice1.doc
- A notice of final external review decision available at: http://www.dol.gov/ebsa/IABDModelNotice3.doc

Model language for the description of the internal claims and appeals and external review procedures in the summary plan description provided to participants and beneficiaries will be posted in the future.

Final Rule Issued on Timing and Order of QDROs

The DOL recently issued a final rule providing guidance on the timing and ordering of domestic relations orders (DROs) under the Employee Retirement Income Security Act of 1974 (ERISA). As in an earlier interim final rule issued in March 2007, the final rule clarifies that a plan administrator may not disqualify a DRO solely because it was issued after, or revises, a prior DRO or qualified domestic relations order (QDRO), or solely because of the timing of the order. For example, a DRO will not fail to be a QDRO solely because it was issued after the death of the participant, after the parties divorce, or after the participant's annuity starting date. All orders must, however, satisfy all the other requirements applicable to QDROs under ERISA. The final rule provides several examples illustrating application of these principles and emphasizes

that the examples do not represent the only circumstances under which the rules apply. (29 CFR 2530)

DOL Expands Prohibited Transaction Exemption for Litigation

The DOL has expanded an earlier prohibited transaction class exemption related to the settlement of claims by a plan against an individual or entity that is a party in interest with respect to the plan. Before this amendment, the DOL had issued a class exemption from the prohibited transaction rules for transactions in which a plan might settle a claim against a party in interest in exchange for cash or other consideration. Despite objections by some commentators, the DOL has consistently held the view that the receipt by a plan of any property (including cash) in consideration for the release of a claim against a party in interest would constitute a prohibited transaction under the law. PTE 2003-39 provided a prohibited transaction class exemption for such transactions provided the terms of the exemption were followed. The issuance of the class exemption closely followed notable circumstances of corporate malfeasance, notably Enron in late 2001, where employee benefit plans had suffered losses and had claims against a party in interest. While the DOL reiterated its view that cash settlements are favored in these circumstances, the amended exemption recognizes that plans might not always be in a position to achieve a cash settlement, and that settlements involving stock, warrants, bonds, or other property might be in the best interest of a plan and its participants. The amended and expanded class exemption, therefore, permits a plan to receive noncash assets in settlement of a claim against a party in interest. The exemption extends to bonds and stock rights that constitute corporate securities even though such securities would not be "qualifying employer securities" under the general ERISA rules. This amended class exemption must be reviewed in any case where a plan and its fiduciaries believe that the plan may have a potential claim against a party in interest to recover assets on behalf of plan participants. (Amended PTE 2003-39, effective June 15, 2010)

CASES

Conflict Between Plan and SPD Ruled in Favor of Participant

The U.S. Court of Appeals for the Eighth Circuit recently reversed and remanded a decision of a district court that upheld an insurer's decision to deny long-term health benefits. The circuit court held that the district court gave too much deference to the insurer's decision to deny the benefits. In this case there was a conflict between the language in the plan document and the summary plan description (SPD) regarding the grant of discretionary authority. The insurer, also the plan administrator, was not granted discretionary authority under the terms of the plan document, even though the plan's summary plan description included such a delegation of authority. In previous cases, courts have generally followed a rule that an SPD prevails over a plan when there is a conflict between the two. The reasoning behind these prior holdings is that the Employee Retirement Income Security Act places a priority on full disclosure and, because an SPD is designed to be understood by the average plan participant, its terms should not be undermined by the provisions of a technical legal document. This case is an exception to this general rule favoring the language in the SPD. The court points out that the rationale behind the "SPD prevails" rule, meant to protect plan participants, is not furthered when the SPD enlarges the rights of the plan administrator at the expense of plan participants when the plan itself does not confer those rights.

Although this case is an exception to the general rule that the SPD prevails, it is consistent with the idea that the language favoring the participant will prevail regardless of which document it is in. This case highlights the importance of confirming that the language in the plan and SPD is consistent, as inconsistencies often lead to unanticipated plan liabilities. (*Ringwald v. Prudential Insurance Co. of America*, 8th Cir. 2010)

No ERISA Breach for Failing to Inform Dying Participant of Optional Plan Benefit

A recent district court case demonstrates how important it is for employers to maintain summary plan descriptions (SPDs) that clearly and unambiguously describe benefits available under their welfare benefit plans. In this case, the widow of a former employee of a company that maintained a life insurance plan sued the company for breach of fiduciary duty for failing to inform her and her husband about an option to accelerate life insurance benefits under a “living benefits” option. The employer’s group life insurance plan permitted a terminally ill participant to elect accelerated payment of a portion of his or her life insurance benefit under certain conditions. If the participant had elected the living benefits option, he would have been entitled to an up-front payment of $100,000 to be deducted from the $300,000 payable to his wife on his death. However, the company employee who advised the participant and his wife about their benefits following diagnosis of the participant’s terminal illness, failed to inform the couple of this option, telling them only of their right to convert the group coverage to individual coverage. The participant failed to convert the policy and his coverage lapsed. Several months later, the participant died, and the insurance company denied the widow’s claim for benefits, triggering her lawsuit against the employer.

Drawing upon a long line of precedent established by the U.S. Court of Appeals for the Seventh Circuit, the district court denied the widow’s claims against the company because the SPD was unambiguous and clearly described the living benefits option available to terminally ill participants. As a result, there was no breach of fiduciary duty, despite the incomplete information communicated in person by the company’s human resources representative. (*Pfiel v. Edward Kraemer & Sons Inc.*, W.D. Wis. 2010)

President and Shareholder Not Liable for Contributions to Multiemployer Plans

A series of welfare and pension trust funds filed an action against the president and shareholder of Hawk, Inc. alleging that the individual was personally responsible for amounts deducted from employees’ paychecks and other amounts not contributed to the relevant multiemployer plans. Hawk, Inc., was currently in a bankruptcy proceeding and the plans could not take further actions against the company other than filing claims with the bankruptcy proceeding. The president and shareholder was successful in having the claims of the plans dismissed on a motion for summary judgment. The court found that plans had not been prepared to offer any evidence indicating that Hawk failed to observe corporate formalities which would result in possible imposition of liability under an alter ego or piercing-the-corporate-veil types of theories or to offer any evidence that the president and shareholder retained personal control over the payroll deductions. Because the plaintiffs failed to state or otherwise present possible evidence to these facts, the court found the dismissal on summary

judgment was appropriate. While the individual in this case was successful, officers and shareholders of companies should be careful to observe all corporate actions and observe all fiduciary duties to avoid any claims by multiemployer plans for personal liabilities for amounts not contributed to a plan. (*Robinson v. Hawk Inc.*, N.D. Ind. 2010)

Third Circuit Rules on Whistleblower Protection and Informal Complaints

Employees are protected under Section 510 of ERISA from discharge, discipline, or other discrimination based on the employee's testimony or participation in any "inquiry or proceeding" related to compliance or enforcement of ERISA obligations. A recent Federal Court of Appeals decision involved complaints made by a director of human resources about her employer's administration of the company's medical plan and the employee's claim that she was improperly discharged as a result of these complaints. The case did not involve a formal DOL inquiry, audit, or other formal proceeding of any sort. The director of human resources claimed that her objections about how employees were enrolled in a discriminatory manner in a medical plan and that management had falsified employee data led to her discharge. The discharged employee filed a lawsuit in which she claimed the benefit of the ERISA "whistleblower" provision protecting against a discharge that is based on a proceeding under ERISA. In a decision that is consistent with the Second Circuit Court of Appeals (covering New York), the Third Circuit Court of Appeals ruled that the whistleblower protection does not apply unless there is a formal proceeding in which the employee participates. The decision was reached despite support for the employee's position by the Secretary of Labor filed in a "friend of the court" brief. (*Edwards v. A.H. Cornell and Son Inc.*, 3d Cir. 2010)

Stock-Drop Case Developments of Interest

Two new, noteworthy stock-drop decisions were recently published. In *Swetic v. Community Nat'l Bank Corp.* (M.D. Fla., 2010), a federal trial court granted the defendant/plan sponsor's motion to dismiss a stock-drop lawsuit commenced by two plan participants who claimed plan fiduciaries breached their ERISA duty in connection with an ESOP's continued investment in stock of the plan sponsor that allegedly resulted in enormous plan losses. The court granted the motion to dismiss because the plaintiffs failed to exhaust their administrative remedies and could not prove that exhaustion would have been futile. It is noteworthy that not all federal courts would agree that exhaustion should be required in fiduciary breach claims. But this court, guided by precedent in the Eleventh Circuit, decided that the exhaustion of administrative remedies is required.

In *Lanfear v. Home Depot Inc.* (N.D. Ga., 2010), a federal trial court granted the defendant/plan sponsor's motion to dismiss a stock-drop lawsuit in which the plaintiffs claimed plan fiduciaries breached their ERISA duty in connection with a defined contribution plan's investment in company stock. The company stock suffered a 16 percent drop in price, which the plaintiffs allege could be traced to improper backdating of stock options and engaging in improper accounting practices. Although the court dismissed the lawsuit, it did not apply the Moench presumption of prudence (i.e., the presumption that a fiduciary's decision to retain or offer company stock as a plan investment is prudent under ERISA, unless the plaintiff can show that the fiduciary knew of dire economic circumstances or an imminent corporate collapse) — the court expressed an opinion that the presumption "runs afoul of ERISA's plain provisions." Instead, the court recharacterized the plaintiffs' prudence claim as essentially being "a claim for a failure to diversify" and then ruled the plan is an eligible individual account pension investing in company stock that is not subject to ERISA's diversification requirements.

Hodgson Russ LLP
ATTORNEYS

Employee Benefits Practice Group

Peter K. Bradley
pbradley@hodgsonruss.com

Anita Costello Greer
anita_greer@hodgsonruss.com

Michael J. Flanagan
mflanagan@hodgsonruss.com

Richard W. Kaiser
rkaiser@hodgsonruss.com

Arthur A. Marrapese, III
Art_Marrapese@hodgsonruss.com