EMPLOYEE BENEFITS DEVELOPMENTS FEBRUARY 2010

Hodgson Russ Newsletter
February 23, 2010

Practices & Industries

Employee Benefits

RULINGS, OPINIONS, ETC.

Mental Health Parity Regulations Issued

On January 22, 2010, the U.S. Department of Labor (DOL), Centers for Medicare and Medicaid Services (CMS), and Internal Revenue Service (IRS) jointly issued interim final regulations implementing the Paul Wellstone and Pete Domenici Mental Health Parity and Addiction Equity Act of 2008 (Act).

Effective for plan years beginning on or after October 3, 2009 (January 1, 2010, for calendar year plans), the Act requires parity between mental health or substance use disorder benefits and medical/surgical benefits with respect to financial requirements (e.g., deductibles, copayments, and coinsurance) and treatment limitations (e.g., day limits and visit limits) under group health plans, including plans delivering benefits through health insurance policies. The Act applies to employers with more than 50 employees that sponsor group health plans that offer mental health and/or substance use disorder benefits. The interim final regulations provide much-needed guidance as to how this broadly worded mandate is to be implemented.

For non-collectively bargained group health plans, the interim final regulations are effective for plan years beginning on or after July 1, 2010 (January 1, 2011 for group health plans maintained on a calendar year basis). For a group health plan maintained pursuant to one or more collective bargaining agreements ratified before October 3, 2008, the regulations do not apply to the plan for plan years beginning before (a) the date on which the last of the collective bargaining agreements relating to the plan terminates, or (b) July 1, 2010, whichever is later.

For violations of the Act that occur before the effective date of the interim final regulations (e.g., violations of the Act in 2010 with respect to calendar year plans), DOL, CMS, and IRS will take into account an employer's good-faith effort to comply with a reasonable interpretation of the Act for purposes of enforcement actions. This enforcement policy, however, does not foreclose private litigation under ERISA; therefore, covered employees, former employees, and their dependents may bring a lawsuit to enforce the Act even where the employer has made a good-faith effort to comply with the Act.

As the title of the Act suggests, the purpose of the Act and implementing regulation is to prohibit group health plans from imposing financial requirements (e.g., deductibles, copayments, and coinsurance), quantitative treatment limitations (e.g., day or visit limits), and qualitative treatment limitations (e.g., medical necessity and medical appropriateness) that are more restrictive for mental health or substance use disorder benefits than for medical/ surgical benefits.

Group health plans that have the following characteristics will need to be reviewed for compliance with the Act:

- More restrictive rules or procedures for mental health andsubstance use disorder benefits than for medical/surgical benefits with respect to (a) the exercise of discretion with respect to the payment and adjudication of claims, (b) preauthorization, concurrent review, and retrospective review, (c) case management, or (d) utilization review.
- Financial requirements, such as copayment requirements, deductibles, and coinsurance levels that are higher for mental health or substance use disorder benefits than for medical/surgical benefits.
- Quantitative treatment limits such as day limits, visit limits, and frequency-of-treatment limits that are more restrictive for mental health or substance use disorder benefits than for medical/surgical benefits.
- Provisions that condition the availability of mental health and/or substance use disorder benefits on the exhaustion of mental health and substance use disorder benefits offered under the employer's employee assistance program (EAP).

As noted, even though the interim final regulations express the intent to honor good-faith efforts to comply with the Act, participants and beneficiaries of ERISA plans who believe that the law has been violated would not be prohibited from filing suit. Therefore, employers that sponsor ERISA-covered group health plans that are currently subject to the Act (but not the regulations) and that fail to meet the parity requirements are exposed to litigation and liability risk.

Now is the time for plan sponsors to review their plans in light of the detailed guidance in the new regulations. Compliance with the new rules is critically important to sponsors of self-insured medical plans. Sponsors of fully insured health plans should seek assurances from health insurance issuers that the policies they underwrite and administer are in full compliance with the Act.

Effective Date Delayed for Guidance on Transportation Benefit Debit Cards

Under section 132 of the Internal Revenue Code, qualified transportation fringe benefits provided by an employer can be excluded from an employee's gross income, up to specific limits. Employers may provide qualified transportation benefits directly by distributing transit passes to employees, or by distributing vouchers that can be used by transit operators as fare media. Employers also may provide these benefits indirectly by reimbursing employees for their incurred and substantiated transit expenses. No substantiation is required where employers directly provide transit passes or vouchers.

In 2006, the IRS issued Revenue Ruling 2006-57 outlining various scenarios where transportation benefits offered by an employer using debit cards or smartcards would be treated as either vouchers or cash reimbursements. Where a smartcard or debit card could only be used to purchase transit fare media, no substantiation is required. Where other things could be purchased with the debit card, substantiation would be needed to receive the tax benefit. The original effective date for this guidance was scheduled for January 1, 2008; however, it was later pushed back to January 1, 2009, and again to January 1, 2010. In Revenue Ruling 2009-95, the IRS once again delayed the effective date of the debit card guidance to January 1, 2011. The reason for the series of delays is to provide relief to mass transit providers who have been unable to update their systems to comply with the IRS requirements for the vouchers described in the 2006 Revenue Ruling.

IRS Progress on 403(b) Document Program

In Announcement 2009-89, the IRS indicated that in the next few months it would publish a revenue procedure providing a program for prototype and pre-approved 403(b) plans. After the establishment of the prototype/pre-approved plan program the IRS would then issue a revenue procedure for individual determination letters for 403(b) plans. To coordinate with these new programs, Announcement 2009-89 indicates that the future revenue procedures will provide for a remedial amendment period allowing for correction of any document failures retroactive to January 1, 2010. For plans in existence prior to January 1, 2010, it is a requirement to receive the remedial amendment relief that a written plan intended to satisfy the requirements of Internal Revenue Code § 403(b) was adopted by December 31, 2009.

COBRA Subsidy — IRS Provides Guidance On Claiming Prior-Year Tax Credit

Under the American Recovery and Reinvestment Act of 2009 (ARRA), employers can claim a tax credit for the 65 percent COBRA premium subsidy when an assistance-eligible individual pays the reduced 35 percent premium. Employers are reimbursed for the premium subsidy through tax credits claimed on IRS Form 941. Recently, the IRS clarified how the credit can be claimed when both coverage and payment do not occur in the same calendar year, stating that employers can claim the tax credit in the year the premium is paid, not in the year coverage is provided. For example, if an assistance-eligible individual does not pay for December's subsidized COBRA premium until January, the employer could claim the tax credit for the 65 percent subsidy in January. Because the ARRA COBRA subsidy was extended in late December, many employers are encountering situations where they receive payments in 2010 for coverage provided in 2009.

Relief from 409A Rules for Changes Required by TARP Advisory Opinions

New guidance issued by the IRS permits financial institutions to change payment terms of nonqualified deferred compensation without automatically violating Section 409A of the Internal Revenue Code of 1986 (Code), if necessary to comply with an advisory opinion issued by the Office of the Special Master for TARP Executive Compensation. The relief provided under Notice 2009-92 is applicable only to recipients of financial assistance under the Troubled Asset Relief Program (TARP) and to employees or other service providers of TARP recipients. On June 15, 2009, the Treasury Department issued an interim final rule setting forth the rules on executive compensation applicable to TARP recipients. Under the rule, TARP recipients may request an advisory opinion on whether a compensation structure is inconsistent with the purposes of TARP. To render a favorable advisory opinion, the special master may determine that changes to a compensation arrangement, including to the time and form of payment of compensation, are necessary for the arrangement to be consistent with the purposes of TARP and the public interest. Because compliance with changes as part of the overall restructuring of a compensation arrangement could result in delays in or accelerations of certain payments, concerns were raised that such changes could result in violations of Code Section 409A. Code Section 409A generally restricts changes in the time and form of payment of nonqualified deferred compensation, and failure to comply with the requirements of the statute could result in severe adverse tax consequences to the recipient of the payments. The relief provided in Notice 209-92 permits a TARP recipient to comply with an advisory opinion without triggering adverse tax consequences under Code Section 409A, provided certain conditions are included in the advisory opinion. The guidance is effective for arrangements addressed in advisory opinion issued after September 30, 2009.

CASES

Risks in ESOP Transactions

Several developments from the federal courts illustrate the risks involved in transactions involving employee stock ownership plans (ESOPs) and corporate ownership. ESOP transactions inherently involve conflicts in interest between plan fiduciaries and equity owners who have management interests or positions in the ESOP company. It is not surprising, therefore, to read of the Department of Labor lawsuit filed against several ESOP trustees alleging that transactions entered into by the trustees constituted breaches of fiduciary responsibility because the ESOP purchase prices were inflated and imprudent. (*Solis v. Mattingly*, E.D. Ky, filed December 4, 2009)

A number of other fiduciary claims have also been the subject of recent federal court actions. One claim involves a distribution made out of an ESOP to a participant based on the plan's most recent valuation. The participant's claim in this case is that plan fiduciaries should have informed the participant that recent financial data about the company was about to result in a significantly higher stock valuation on the next valuation date. In fact, the stock price increased by more than 600 percent at the next valuation, which occurred only three months after the lower-valued plan distribution was made. In ruling on a motion to dismiss, the court found that while there was no direct claim for a failure to provide interim stock valuation information, there was a valid claim, to be proved with sufficient credible evidence, that plan fiduciaries acted improperly by encouraging a lump sum distribution based on the earlier valuation and a misrepresentation of the company's financial future. (*Balsley v. Delta Star Employee Stock Ownership Plan*, N.D. Cal. 2009)

Two other cases involve claims against individuals who were not "parties in interest" under the prohibited transaction rules but who will have to defend liability claims that they "knowingly participated" in a prohibited transaction by someone who is a party in interest. One case involves a claim that excessive compensation was paid to a CEO that allegedly depressed the value of ESOP stock. Despite finding that the defendant in the case was not a party in interest at the time the compensation package was approved, the allegations were sufficient to allow the plaintiffs to proceed with their case in attempting to show that the defendant had sufficient knowledge of the transaction and an interest in the matter (the allegedly overpaid executive was the defendant's brother) to establish liability for knowingly participating in the prohibited transaction of his brother. (*Stanton v. Couturier*, E.D. Cal. 2009)

The last case involves the highly visible ESOP transaction established for the Tribune Company, owner of numerous newspapers, television stations, and the Chicago Cubs, among other assets. The court in this case dismissed direct claims against the CEO and board of directors for actions taken in their business capacity as managers of the company's business. These decisions include the decision to create the ESOP and to enter a transaction with the ESOP. On the other hand, the

ESOP trustee will have to defend its decisions to complete various transactions as the ESOP fiduciary, and the officers and directors could be held liable for knowingly participating in a deal that the officers and directors knew would breach fiduciary obligations and thus be prohibited transactions. (*Neil v. Zell*, N.D. Ill. 2009)

All of these court actions point out the inherent risks on ESOP transactions, the wisdom of obtaining independent fiduciary assistance and advice, and the extra caution needed generally when buying or selling stock through an ESOP.

Second Circuit Court of Appeals Issues 401(k) Fees Case Ruling

There has been recent activity in a number of cases involving claims of excessive 401(k) plan fees. In December, the Second Circuit (the federal appeals court that covers New York) issued a summary order affirming the judgment of a federal trial court in a case in which 401(k) plan participants asserted, among other things, that the company and the plan's fiduciaries breached their fiduciary duties under ERISA when the plan offered mutual funds as investment options with what the participants alleged were unreasonable fees and expenses. The plan participants claimed the company and the plan's fiduciaries failed to properly evaluate the mutual fund options, and allowed the plan to pay excessive investment management and brokerage fees. The Second Circuit did not offer any rationale in its summary order, but indicated the trial court's decision was "thorough and well-reasoned." In the trial court decision, the court determined that the evaluation process used to select the investment options and assess the fees gave appropriate consideration to the fees and expenses charged by the mutual fund managers. It is worth noting that while this decision does not have precedential effect on future decisions in the Second Circuit (because the ruling was made in the form of a summary order), this case certainly could influence other courts that consider 401(k) fee claims in the Second Circuit. It is also worth noting that while the rulings in cases like this one in the Second Circuit have largely been favorable to the plan sponsors, further case law developments in this area are expected. (*Taylor v. United Technologies Corp.*, 2nd Cir. 2009)