EMPLOYEE BENEFITS DEVELOPMENTS JUNE 2009

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Employee Benefits

IRS Issues "Dirty Dozen" List of Tax Scams

The Internal Revenue Service (IRS) recently warned taxpayers to be wary of the tax scams listed in its 2009 "dirty dozen" list. The IRS publishes this annual list to help unsuspecting taxpayers avoid common illegal tax schemes. One item on the IRS list for 2009 is abusive retirement plans. Specifically, the IRS is looking for transactions that taxpayers are using to avoid the limitations on contributions to Individual Retirement Arrangements (IRAs) as well as transactions that are not properly reported as early distributions. Taxpayers should be cautious of advisers who encourage them to shift appreciated assets into IRAs or companies owned by their IRAs at less than fair market value to get around annual contribution limits. The IRS reminds us that if the arrangement seems too good to be true, it probably is. *IR-2009-41*.

IRS Proposes 403(b) Prototype Plan Program

The IRS issued Announcement 2009-34, stating its intention to establish a program for the pre-approval of prototype plans under section 403(b) of the Internal Revenue Code (Code). The 403(b) prototype program will generally operate in the same manner as the current master and prototype program for plans qualified under section 401(a) of the Code. The announcement includes a draft revenue procedure and rules for the issuance of opinion letters for 403(b) prototype plans.

Under the program, a 403(b) prototype plan sponsor will submit a plan document to the IRS for review. If the plan satisfies the requirements of Code section 403(b), the IRS will issue a favorable opinion letter to the sponsor with respect to the plan document. The sponsor may then offer the approved plan document for adoption by employers, with the assurance that the plan meets requirements of the Code and the 2007 regulations. The draft revenue procedure includes a retroactive remedial amendment period for years after 2009. The IRS also issued draft sample plan language on its website (irs.gov) for use in drafting 403(b) prototype plans.

This announcement follows previous guidance regarding compliance with the 2007 regulations. In 2007, the IRS issued Revenue Procedure 2007-71, which included model language that public schools and other eligible employers could use to comply

with Code section 403(b) and the final regulations. Employers may continue to rely on the 2007 guidance until further notice.

In addition to the prototype program, the IRS intends to establish a determination letter program for individually designed 403(b) plans. This will provide sponsors of individually designed 403(b) plans with an opportunity to have the IRS review their documents as to form with regard to the documents' compliance with Code section 403(b) and regulations. The date for the establishment for the determination letter program for individually designed plans has yet to be determined.

Severance Plan Changes Are Permissible Settlor Function

Less than three months before the sale of one of its facilities, Kimberly-Clark Corp. amended its severance plan to provide that severance benefits would not be available for employees involuntarily terminated as a result of certain events, including a sale of any portion of the company. A group of former employees affected by the sale of the facility sued the company, claiming that Kimberly-Clark, as plan sponsor and administrator, acted in its own interest and, in conflict with the interests of the plan's participants, when it amended the plan. This conflict, the former employees argued, rendered the amendment invalid. Kimberly-Clark argued that its decision to amend the plan was a "settlor" function under the Employee Retirement and Income Security Act (ERISA), not a fiduciary function. Accordingly, the company argued that it was well within its rights to act in its own best interests in connection with the adoption of the amendment. The court agreed with the company holding that the amendment was a proper and legitimate exercise of the company's rights as an employer. The employees did not claim they were eligible for benefits under the plan as amended or that the company did not properly follow the plan's amendment procedures. The lesson of this case is that ERISA welfare plan benefits, like severance benefits, generally are not "vested" until the occurrence of the event that gives rise to the benefits. Accordingly, a properly executed plan amendment, adopted before the occurrence of the event triggering payment, will generally be upheld. In addition to following proper amendment procedures, it is prudent to give participants advance notice of any such amendment. *Wilson v. Kimberly-Clark Corp.* (S.D. Miss. 2009).

Multiemployer Plan Contribution Liability Found to Extend to Multiple Entities

Springman Electric and Springman Electric, Inc. had each consented to the provisions of certain collective bargaining agreements that required monthly contributions to certain multiemployer welfare benefit plans. For reasons that appear to include a desire to avoid coverage under the collective bargaining agreements, members of the Springman family formed numerous companies to perform similar electrical work with each entity using a variation of the Springman name. The trustees of the welfare benefit plans sued to hold each of the associated entities liable for unpaid contributions to the multiemployer plans. The associated entities were found to be liable for these contributions under two theories. First, liability was imposed under a successor liability theory with the District Court for the Southern District of Illinois finding that successor had prior notice of the claim and there had been a substantial continuity in business operations of the predecessor. Second, the court found that the entities were also liable under an alter ego theory. The court found that an alter ego theory is distinct from successor liability in that an unlawful motive or intent is a critical part of the inquiry.

Applying Illinois law, the court held that to proceed with an alter ego theory, it must be established that there is a unity of interest of ownership such that the separate personalities of the entities no longer exist and that the adherence to the fiction of separate existence would sanction a fraud or promote injustice. The court found the intent to commit fraud or promote injustice from the testimony by one of the family members, that he was "getting hosed by the IBE" and that one of the reasons for the shutdown of the entity, which was obligated to contribute under the collective bargaining agreement, was that because it owed contributions to the multiemployer plans. *Trustees of the NECA-IBEW Pension Benefit Trust Fund v. Springman* (S.D. Ill. 2009).

Corporate Form Protects Personal Assets

Multiemployer union pension and benefit funds were owed over $1 million in unpaid contributions by an insolvent drywall contractor when the funds filed suit to attempt collection from individual shareholders of the corporate employers who owed the contributions. The legal theory of the multiemployer plans was based on disregarding the corporate entities where shareholders do not observe the formalities of the corporate form or otherwise act in a manner that would allow the fund to look through the corporation, "piercing the corporate veil," to hold shareholders personally liable for corporate debts. While the court found that the corporate records were incomplete or lacking in some respects, the shareholders effectively maintained their corporations as separate entities and properly accounted for corporate income and expenses, compensation payments, and dividends. Accordingly, the court concluded that there was no legal basis to hold the shareholders liable for corporate debts, including the multiemployer plan contributions. This case illustrates the importance of following the formal procedures involved in taking corporate action — including regular board of directors meetings, maintaining a minute book, providing for delegation of responsibilities to officers, and executing legal documents in a corporate capacity. *Malcolm v. Franklin Drywall, Master Drywall, Philip J. Franklin* (D. Minn. 2009).

Plant Shutdown Did Not Constitute Interference with Pension Benefits

In a case of interest given the current economic downturn, a federal appeals court recently ruled that an auto parts manufacturer did not interfere with the vesting of retirement benefits for a class of former employees, and thus did not violate ERISA, when it closed the plant where they worked. In its ruling, the court rejected the manufacturer's assertion that ERISA interference claims in the plant sale or closing context are never actionable. On the other hand, the court also rejected the employees' argument that the company violated ERISA § 510 when it did not recall or transfer them to another plant — the court ruled that ERISA § 510 does not include the right to be recalled or transferred if the discharge itself was otherwise lawful. The court ultimately ruled in favor of the manufacturer because it found that while pension costs were among the reasons to close down the plant, the employees were unable to show that the intent to interfere with their ERISA rights was the "motivating factor" behind the plant closing. *Crawford v. TRW Automotive U.S. LLC* (6th Cir. 2009).

Pension Plan Benefits Protected From Personal Creditors

The strong protection afforded to qualified pension benefits is illustrated in a case where the creditor seeking payment from a retiree is the plan itself. Here is a case where an individual owner of a business was obligated through a collective bargaining agreement to make contributions to a multiemployer pension plan, and the same individual was also a participant in that plan who had earned pension benefits over a number of years. When the business started to experience financial troubles and became delinquent in contributions, the individual business owner signed a personal promissory note to the plan to settle collection actions taken by the plan. Subsequently the business ceased operations, the owner applied for and began receiving retirement benefits and then he filed an individual bankruptcy petition, listing the plan and the promissory note as one of his creditors. The pension fund sought to offset the retirement benefits with the outstanding amount on the promissory note. This attempt was rebuffed by the bankruptcy court and subsequently affirmed by both the Federal District Court and Court of Appeals. The court rulings affirmed two principles in this area. First, creditors are precluded from pursuing collection actions once a bankruptcy petition has been filed. Second, the "anti-alienation" rules of ERISA prohibit a plan from offsetting a pension benefit with a liability owed to the plan or the sponsoring employer. There are exceptions to the anti-alienation rule, most notably for tax liabilities and for plan loans to participants that are secured with the participant's account balance. In this case, the plan's attempt to characterize the promissory note covering employer contribution liabilities as an element of the individual plan participant's accrued benefit was unsuccessful. *In re Radcliffe* (7th Cir. 2009).

PBGC Termination Premium Non-Dischargeable in Bankruptcy

As part of the Deficit Reduction Act of 2005, a new "termination premium" was instituted for defined benefit plans terminating pursuant to a Chapter 11 reorganization proceeding (or similar state law proceeding) or in a distress termination outside of an insolvency proceeding. The termination premium is $1,250 multiplied by the number of participants immediately before the plan termination date and is payable for three years. For a plan terminated during a bankruptcy reorganization proceeding, the termination premium does not apply until the date of discharge or dismissal of the debtor in the case.

Oneida Ltd. filed a Chapter 11 reorganization proceeding and, during that proceeding, terminated its defined benefit pension plan. Oneida Ltd. brought an action claiming that the termination premium was an unsecured pre-petition bankruptcy claim that should be discharged within the bankruptcy proceeding. The bankruptcy court ruled in favor of Oneida Ltd.

The Court of Appeals for the Second Circuit reversed the decision of bankruptcy court. The Second Circuit found that the obvious purpose of the rule stating that the termination premium does not apply until the date of discharge or dismissal of the debtor was to prevent employers from evading the termination premium in bankruptcy.

Employers looking to terminate a defined benefit plan in a distress termination are advised to take into consideration the termination premium and the potential significant economic effect on the plan sponsor going forward after termination of the plan. *Pension Benefit Guaranty Corporation v. Oneida, Ltd.* (2nd Cir. 2009).

Third Circuit Adopts New Approach When Confronted With Conflicts of Interest

Drawing upon a recent decision of the U.S. Supreme Court in *Metropolitan Life Insurance Co. v. Glenn*, 128 S.Ct. 2343 (2008), the U.S. Court of Appeals for the Third Circuit adopted a new approach to cases involving a plan administrator operating under a conflict of interest, subsequently reversing a lower court decision involving a denial of severance benefits to a terminated employee. Prior to *Glenn*, the Third Circuit considered conflicts of interest affecting plan administrators when formulating the standard of review in benefits-related cases involving a potential abuse of discretion, and applied a "sliding scale" to determine the level of deference accorded to the plan administrator in such situations. In *Glenn*, the Supreme Court held it was not necessary or desirable for courts to create special procedural, evidentiary, or burden-of-proof rules to account for conflicts of interest when conducting a review of a benefits denial under the Employee Retirement Income Security Act. In light of *Glenn*, the Third Circuit found its sliding scale approach no longer valid, and determined that a conflict of interest should be considered merely one of several factors in determining whether the administrator or fiduciary abused its discretion in denying a claim for benefits.

The case before the court involved an employee who sought benefits under his company severance plan following his termination. The company's Employee Benefits Committee (Committee), which served as plan administrator, denied the claim on the basis that the employee was terminated for misconduct. The employee challenged the claim of misconduct and the denial of benefits, and, following exhaustion of his appeal rights under the plan, filed suit in district court. Finding a conflict of interest in the dual role of an attorney who served as attorney for both the Committee and the company, the district court applied a heightened standard of review. Under the heightened standard, the court concluded that the Committee's decision was tainted by the conflict of interest and ruled in favor of the employee. On appeal, the Third Circuit reversed, finding that the attorney's role on the Committee was merely advisory and did not taint the Committee's decision, especially given the "abundance of evidence" that misconduct had occurred. *Estate of Schwing v. Lilly Health Plan* (3rd Cir. 2009).

Second Circuit Rules *LaRue* Decision Not Applicable to a Cash Balance Plan

In the important 2008 *LaRue* case, the Supreme Court ruled that individual participants in 401(k) and other retirement plans may sue plan fiduciaries to recover investment losses from their accounts, and may do so without seeking relief on behalf of the entire plan. In a recent case in the U.S. Court of Appeals for the Second Circuit, a plan participant tested the notion of whether the *LaRue* decision applies to cash balance plans. The plaintiff in the case participated in a cash balance plan. The plaintiff sued, claiming that the defendants breached their fiduciary duties under ERISA when the plan denied his application for a lump sum benefit. The appeals court upheld the decision of the trial court to dismiss the plaintiff's claim because he was seeking individual relief, rather than relief on behalf of the plan. In reaching its decision, the appeals court concluded that *LaRue* was not applicable because the plan in this case was a form of defined benefit plan under which individual accounts were not maintained, as contrasted against the *LaRue* decision which involved a defined contribution plan where participants did have individual accounts. *Fisher v. Penn Traffic Co.* (2nd Cir. 2009).