EMPLOYEE BENEFITS DEVELOPMENTS JULY 2008

Hodgson Russ Newsletter
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Practices & Industries

Employee Benefits

RULINGS, OPINIONS, ETC.

New Genetic Information Nondiscrimination Law. The recently signed Genetic Information Nondiscrimination Act of 2008 (GINA) prohibits insurers, group health plans, and employers from discriminating against individuals on the basis of their genetic information or the genetic information of their families.

The provisions of GINA concerning group health plans become effective for plan years beginning after May 21, 2009 (January 1, 2010 for calendar year plans). However, the employment-related provisions become effective November 21, 2009.

Group Health Plans/Insurers. GINA amends the Health Insurance Portability and Accountability Act (HIPAA) nondiscrimination rules, the Public Health Services Act, and the Internal Revenue Code. Under GINA, insurers and group health plans are prohibited from:

- requiring a higher employee contribution based on genetic information
- restricting enrollment or charging a higher premium based on genetic information or use of a genetic service (genetic counseling or genetic education)
- requiring genetic testing

Although group health plans cannot *require* genetic testing, genetic testing may be requested as long as the plan clearly states that compliance is voluntary and noncompliance will not adversely affect enrollment or the amount of the required contribution.

Genetic information is defined as an individual's genetic tests, disorders, and diseases, and those of his or her family. GINA amends HIPAA privacy and security provisions by including genetic information in the category of protected health information. Therefore, group health plans should review their HIPAA privacy and security policies and handle genetic information in accordance with those policies.

Employment. GINA extends Title VII of the 1964 Civil Rights Act by prohibiting employers from using genetic information as a basis for termination, limiting employment opportunities, or determining an employee's compensation, terms, conditions, or privileges of employment. Employers are also prohibited from disclosing genetic information except under certain specific circumstances.

In light of this legislation, employers and plan sponsors should undertake a review of their welfare plan documents and insurance contracts to ensure that genetic information is not a factor in determining premiums, employee contributions, eligibility, or benefits. In addition, HIPAA policies and procedures should be reviewed and amended to reflect the protected status of genetic information.

New Law Enhances Benefits for Employees Called to Military Service. The Heroes Earnings and Assistance and Relief Tax Act of 2008 (HEART Act) builds on the Uniformed Services Employment and Reemployment Rights Act (USERRA) to afford enhanced benefits for those in military service. Summarized below are some of the highlights.

HEART Act Provisions Affecting Retirement Plans
Tax-qualified retirement plans, including 403(b) and 457 plans,

- *must* treat participants who die while performing USERRA-qualified military service as if they had died while actively employed for purposes of applying plan provisions relating to survivorship benefits (e.g., full vesting and ancillary death benefits)
- *may* treat individuals who die or become disabled while performing USERRA-qualified military service as if their death or disability had occurred immediately after reemployment to enable, for example, a plan to credit the individual's plan account with the retroactive benefit accruals he or she would have received under USERRA upon a qualifying reemployment

These requirements apply to deaths and disabilities occurring on or after January 1, 2007.

In addition, effective for years beginning after December 31, 2008, a tax-qualified plan may permit a participant who is on active military duty for more than 30 days to receive a distribution of his or her elective deferrals. This is accomplished by treating the individual as if his or her employment had been terminated. As with safe harbor hardship distributions, the participant's right to make on going elective deferrals will be suspended for six months following the distribution.

HEART Act Provisions Affecting Cafeteria Plans
Effective June 17, 2008, a cafeteria plan may permit a reservist called to active duty to receive a distribution of unused health FSA amounts. The purpose of this provision is to prevent a reservist called to active duty from forfeiting his or her unused balance under the "use it or lose it" rule. The distribution must constitute a "qualified reservist distribution." A qualified reservist distribution is a distribution (a) to an individual who is a member of a military service unit ordered or called to active duty for a period in excess of 179 days or for an indefinite period (b) that is made between the date of the order or call to active duty and the last date that reimbursements from the health FSA could otherwise be made for the plan year that includes the date of the order or call to active duty (i.e., the last day of the claims submission period following the end of the plan year).

CASES

Termination of Severance Benefit Plan Allowed Where Benefits Are Not Vested. A recent case from the U.S. Court of Appeals for the Ninth Circuit reminds us that an employee does not have a vested right to a welfare plan benefit unless the plan clearly and expressly provides for vesting. A group of employees filed suit against their employer after the employer terminated a severance plan. The court ruled the employer was free to terminate the severance plan because the plan document and the summary plan description did not expressly vest welfare benefits and plainly reserved the employer's right to terminate the severance plan. In doing so, the court stated that while welfare benefits do not automatically vest under the Employee Retirement Income Security Act of 1974 (ERISA), it is possible for the employer to agree to vest welfare benefits. However, such an agreement must be found in the plan documents and must be stated in clear and express language. The employees argued that the employer's employee handbook constituted a "binding agreement" that vested welfare benefits and therefore precluded the employer from terminating the severance plan. The court disagreed because the employee handbook did not contain sufficient information to qualify as a plan document. The court noted that even if it could characterize the employee handbook as a plan document, the employee's argument would fail because the employee handbook did not vest benefits in clear and express terms, and did not convey rights apart from, or greater than, those contained in the severance plan. (*Gonzales v. Phelps Dodge Miami, Inc.* (9th Cir. 2008))

Phone Reimbursement Plan for SBC Retirees is ERISA Pension Plan. Prior to the break up of American Telephone and Telegraph & Telegraph Co. (the Bell System) in 1984, the Bell System provided its employees and retirees with free and discounted telephone service. Part of the program was a concession plan for out-of-region employees and retirees (the Concession Plan) covering those individuals who did not have access to the Bell System services. The Concession Plan provided reimbursements for the cost of purchasing phone service from local carriers. When the Bell System was broken up into seven companies, each of the seven companies agreed that eligible pre-break up retirees would continue to receive a comparable Concession Plan. A group of retirees of Southwestern Bell sued the parent holding company (SBC) claiming that they had mismanaged the Concession Plan in violation of ERISA.

In the first phase of this case, the District Court for the Western District of Texas found that the Concession Plan constitutes an ERISA pension benefit plan. The court found based on the materials presented into evidence that a reasonable person could ascertain the intended benefits, the class of beneficiaries, the source of financing, and the procedures for receiving benefits. The court rejected the argument made by SBC that the Concession Plan was not intended to provide retirement income. The court found that the benefit resulted in regular payments to individuals commencing at their retirement and that the amounts represented taxable income.

Employers that offer plans to retirees with certain so-called fringe benefits that result in taxable income should look carefully at their plans to determine whether a court could find that the plan was an ERISA pension benefit plan that would require full compliance with the funding and vesting rules of ERISA. Note, with respect to benefits such as this, it may be difficult to design a plan structure to comply with the requirements of ERISA that does not result in unintended tax consequences. (*Stoffels v. SBC Communications Inc.* (W.D. Tex., 2008))

Pennsylvania Law Revoking Beneficiary Designations for Ex-Spouses Preempted by ERISA. Reversing a lower court, the Pennsylvania Superior Court ruled in a 2-1 decision that ERISA preempts a Pennsylvania law revoking spousal beneficiary designations upon divorce. The case concerns a group life insurance policy issued to a Pennsylvania employee in 1997. Following his marriage in 1998, the employee named his new wife as the primary beneficiary and his nephew as the contingent beneficiary of the policy. The couple divorced in 2002, but, as is often the case, the employee neglected to remove his ex-wife as the beneficiary of his life insurance policy. Upon the employee's death in 2006, the insurance company paid the proceeds to his ex-wife as named beneficiary. The estate then sued the ex-wife to recover the benefits, claiming that under Pennsylvania law, the employee's designation of his ex-wife as beneficiary was automatically revoked upon their divorce. The ex-wife countered that she was entitled to the benefit because the state law was preempted by ERISA. The trial court ruled in favor of the estate and ordered the transfer of the benefits to the nephew.

The state statute in question (20 Pa. C.S.A. § 6211.1) provides that if, at the time of death, a Pennsylvania resident is divorced after designating his spouse as beneficiary of a life insurance policy, pension plan, or other contractual arrangement providing for payments to his spouse, any revocable designation in favor of that former spouse will become ineffective. Rather, the policy or contract will be construed as if the former spouse had predeceased the individual, unless there is a court order or contract indicating that the designation was intended to survive the divorce. In finding for the ex-wife, the appeals court relied on the 2001 U.S. Supreme Court decision *Egelhoff v. Egelhoff*, in which a similar Washington state law was struck down because it was preempted by ERISA. The Pennsylvania court found that, like the Washington statute in *Egelhoff*, the Pennsylvania law would compel the administrator of an ERISA plan to determine beneficiary status, not according to the plan's documents, but based on state law. Under the same rationale, the appeals court found the Pennsylvania law has an impermissible connection with ERISA-governed plans because it interferes with nationwide uniform benefit plan administration by requiring "plan administrators to familiarize themselves with a state law to determine beneficiary status." (*In re Estate of Sauers* (Pa. Super. Ct. 2008))