Hodgson Russ LLP
ATTORNEYS

EMPLOYEE BENEFITS DEVELOPMENTS MAY 2014

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Attorneys

Peter Bradley

Michael Flanagan

Richard Kaiser

Ryan Murphy

Practices & Industries

Employee Benefits

CASES

Retired Executives Win Reinstatement of Terminated SERP Benefits

Three retired executives of Bausch & Lomb Inc. have won a district court battle to reinstate their supplemental executive retirement plan (SERP) benefits, which were terminated following a 2007 acquisition of the company by a private equity firm. As the only participants in the SERP, the three former executives were receiving monthly supplemental benefits for life at the time of the acquisition. The benefits were funded by irrevocable secular trusts established by the company. In connection with the pending acquisition, the executives were informed that the SERP's change in control provisions required the termination of the plan and the conversion of their lifetime monthly benefits into lump-sum payments. Arguing that the projected lump-sum payments were significantly less than the present value of the annual after-tax benefits to which they were entitled under the SERP, the executives objected to the discontinuance of the monthly installments. They disputed the company's right to terminate the SERP and pay out lump sums, pointing to plan provisions that required the plan and the trusts to continue in effect and survive any change of control and that arguably limited lump-sum payments on a change of control to participants who were still active employees. Subsequent claims appeals were denied by the company, resulting in a 2009 lawsuit challenging the termination of their monthly benefits and the calculation of their lump-sum payments. The executives claimed that the lump-sum payments were less than the present value of the benefits to which they were entitled, and the company's right-of-reversion to amounts in the trusts created a conflict of interest that influenced the determination of their claims.

Ruling on competing motions for summary judgment, the district court sided with the executives, ruling that the company violated the Employee Retirement Income Security Act (ERISA) when it converted the benefits to lump-sum payments and terminated the SERP. Faulting the company for its procedural violations, the court found that the company employees who made the original decision to terminate the plan acted as unauthorized plan fiduciaries by engaging in actions that were

discretionary in nature. The court found that the employees lacked the discretionary authority to interpret the "hotly disputed" plan terms, to determine the rights and benefits of participants, or to act as fiduciaries under the plan. Although the "adverse benefit determination" by unauthorized parties would normally require a *de novo* standard of review, the court found the company's decisions could not withstand scrutiny even under the deferential "arbitrary and capricious" standard. The court pointed to the company's "pervasive bad faith" in dealing with the executives, the "flagrant procedural violations," and the evidence of a "structural conflict of interest" during the internal appeals process. Noting that the three directors on the appeals committee stood to benefit financially from trust provisions that required the return of any excess assets to the company after payment of the benefits, the court concluded that the potential for a multi-million dollar reversion biased the decision making. Granting summary judgment to the executives, the court vacated the company decisions terminating their benefits under the SERP. (*Gill v. Bausch & Lomb Supplemental Ret. Income Plan I*, W.D.N.Y., 2014)

Tussey v. ABB, Inc.: Court Rules on Various 401(k) Plan Fiduciary Issues

The Eighth Circuit Court of Appeals decided a case in which it addressed a variety of fiduciary breaches alleged by employees participating in an employer's 401(k) plans. Under the plans, each participant decided how to allocate individual contributions among the investment options selected to be part of the plans. The participants sued the plan fiduciaries and Fidelity Management Trust Company.

The federal district court that first heard the case found the plan fiduciaries guilty of a number of fiduciary breaches that included a failure to monitor recordkeeping costs, a failure to negotiate rebates for the plans from either Fidelity or other investment companies, selecting more expensive share classes for the plans' investment platform when less expensive share classes were available, and removing the Vanguard Wellington Fund from the investment fund lineup and replacing it with Fidelity's Freedom Funds. The district court also found that the employer and its employee benefits committee violated their fiduciary duties by agreeing to pay Fidelity an amount that exceeded market costs for plan services to subsidize other corporate services provided to the employer by Fidelity, including payroll services and recordkeeping for the employer's defined benefit and health-welfare plans. Finally, the district court found that Fidelity breached its fiduciary duties to the plans when it failed to distribute float income solely for the interest of the plans and further violated its fiduciary duties when it transferred float income to the plans' investment options instead of the plans.

Several millions of dollars were awarded for the losses and damages suffered as a result of these breaches. The plan fiduciaries and Fidelity appealed the decision of the district court. The Eighth Circuit Court of Appeals affirmed, reversed, and vacated various portions of the district court's decision.

Standard of Review. The Eighth Circuit opinion points out that the district court never clearly identified the specific standard of review that would be used by the court to review the actions taken the by the plans' fiduciaries. Given the grant of discretion in this case, the Eighth Circuit concluded that the district court should have reviewed the determinations of the plans' fiduciaries under the more deferential abuse of discretion standard, and should not have engaged in a *de novo* review of those determinations. Under the "abuse of discretion" standard, the court must uphold a fiduciary's interpretation of a plan as long as it is "reasonable." The Eighth Circuit noted that the plans gave plan fiduciaries and administrators (and their agents) "sole and absolute discretion" to determine plan eligibility and plan benefits, and empowered them "to take

any other actions with respect to questions arising in connection with the plan, including...the construction and interpretation of the terms of the plan." That broad grant of discretionary authority, the Eight Circuit concluded, entitles the plan fiduciary or administrator "to deference in exercising that discretion."

Failure to Monitor Recordkeeping Costs. The Eighth Circuit ruled that the district court did not err by concluding that the plan fiduciaries failed to monitor and control recordkeeping fees and paid excessive revenue sharing from plan assets to subsidize the employer's other corporate services. The Eighth Circuit ruled that record supported the district court's conclusion that the plan fiduciaries failed to (1) calculate the amount the plans were paying Fidelity for recordkeeping through revenue sharing, (2) determine whether Fidelity's pricing was competitive, (3) adequately leverage each plan's size to reduce fees, and (4) make a good-faith effort to prevent the subsidization of administration costs of the employer's other corporate services with plan assets, even after the employer's own outside consultant notified the employer the plan was overpaying for recordkeeping and might be subsidizing the employer's other corporate services. The Eighth Circuit also ruled that the district court's failure to afford deference to the plan administrator's interpretation of the plans with respect to recordkeeping and revenue sharing was harmless under the circumstances. As a result, a $13.4 million judgment against the employer was upheld.

Selection of Plan Investment Options and Mapping. With regard to the removal of the Vanguard Wellington Fund and mapping from the Wellington Fund to Fidelity's Freedom Funds, the Eighth Circuit found that the district court erroneously substituted its own *de novo* plan interpretation and view of the ideal plan investments for the reasoned judgment of the plan fiduciaries. The Eighth Circuit concluded that the district court did not show appropriate deference to the plan fiduciaries in evaluating whether they, based on what they knew at the time they made their investment decisions, breached their fiduciary duties in evaluating, selecting, and implementing the new plan investment fund option. The Eighth Circuit also concluded that the district court's opinion improperly relied on hindsight to evaluate the prudence of the investment selection. As a result, the Eighth Circuit vacated the district court's $21.8 million judgment and award on this claim and remanded it for further consideration.

Float Income. Fidelity appealed the district court's conclusion that Fidelity breached its fiduciary duties of loyalty by failing to pay float income to the plans (i.e., interest income accrued on plan contributions held in a depository account before those contributions are invested in a selected investment option). Fidelity argued that, as a matter of basic property rights, the investment options, not the plans, owned the float and bore the risk of loss with respect to the float accounts and thus were entitled to any benefits of ownership. The evidence indicated that when a contribution was made, Fidelity credited the participant's plan account, and the plan became the owner of the shares of the selected investment option (typically, shares of a mutual fund) the same day the contribution was received. Once the plan became the owner of the shares, it was no longer also owner of the money used to purchase them. As a result, the investment funds, not the plans, held the property rights in the depository float and were entitled to the float income. Accordingly, the Eighth Circuit ruled that Fidelity did not breach any fiduciary duties with respect to the depository account. The Eighth Circuit also ruled that the participants failed to establish the plans had any rights in the redemption account balance (i.e., the account that holds funds pending the participant's cashing of a distribution check). The participants did not cite any record in evidence establishing the plans as the owner of the funds in the redemption account and, absent proof of any ownership rights to the funds in the redemption account, the plan had no right to float income from that account. The Eighth Circuit was not unanimous on the float income issue. A dissenting opinion argued that contributions to the plans are plan assets at the time

they are placed into Fidelity's depository account, thus making depository float income a plan asset that Fidelity improperly used for its own benefit. (*Tussey v. ABB, Inc*., 8th Circuit, 2014)

Long Legal Journey of Case Defining Meaning of Partial Termination May Have Come to a Close

After 18 years, the district court in the District of Illinois ruled that a partial termination of a 401(k) plan did not occur. Household International Inc. sponsored a 401(k) plan. In 1996, Household decided to sell several of its subsidiaries, which resulted in a termination of a number of employees covered under the 401(k) plan. Employees whose employment was terminated forfeited the unvested potion of the employer matching contribution in the 401(k) plan if they had not worked long enough to be fully vested. A former employee filed a lawsuit claiming that a partial termination had occurred and that affected participants should be fully vested. *Matz vs. Household International* is a well-known case that provides some guidance in determining if a partial termination had occurred. This case has gone through district courts, courts of appeals, and even the U.S. Supreme Court. Finally after this long legal history, the District Court for Northern District of Illinois disagreed with the former participants that a partial termination had occurred. The issue that was crucial in this determination was whether several sales of subsidiaries should be viewed as a single corporate act or whether they should be viewed separately. This becomes important in determining the percentage of affected employees for the partial termination rules. The district court held that the decisions made to sell the subsidiaries were made a different times and based on different market conditions; they were not viewed as part of a single corporate event. By making this determination, the district court found the number of affected employees was approximately 5 percent. This fell below the rule generally followed by courts that a percentage below 10 percent is an absolute rule that a partial termination had not occurred. Under this rule, the range of between 10 percent and 20 percent creates a rebuttable presumption that a partial termination had not occurred, and a percentage above 20 percent creates a presumption that a partial termination had occurred. (*Matz v. Household Int'l Tax Reduction Inv. Plan*, N.D. Ill., 2014)

Owners of Contributing Employer to Multiemployer Pension Plan Liable for Breach of Fiduciary Duty

An ERISA fiduciary includes any person who exercises any authority or control over plan assets. If an ERISA fiduciary breaches his or her fiduciary duties with respect to a plan, he or she is personally liable to the plan for the breach.

In general, employer contributions (other than amounts withheld from employees' pay) become plan assets only after actually being contributed to the relevant plan. However, in the context of a multiemployer fund, some courts have carved out an exception to this general rule where the plan documents provide that delinquent employer contributions constitute plan assets.

Floppy Mop was a contributing employer to a number of multiemployer funds providing pension, health and welfare, and other benefits. In a prior lawsuit, the funds had obtained a default judgment against Floppy Mop in the amount of $535,158 for unpaid employer contributions to the funds. After Floppy Mop failed to pay the judgment amount, the funds brought

suit against Floppy Mop's owners, alleging that the owners were ERISA fiduciaries by virtue of their exercising authority and control over plan assets.

The trust agreements provided that "contributions paid, and due but not yet paid, are Trust Fund Assets." Similarly, the funds' collection policy specified that "all money owed to the trusts, which money (whether paid, unpaid, segregated, or otherwise traceable, or not) becomes a trust asset on the due date." This language, the district court held, made clear that delinquent employer contributions were plan assets.

The district court then held that Floppy Mop's owners exercised authority and control over plan assets. Among other factors noted by the court in support of its holding were:

• The owners formed Floppy Mop, no other individuals were ever owners of Floppy Mop, and the owners were Floppy Mop's only officers.

• Floppy Mop's owners were the only individuals with check-writing authority for Floppy Mop.

• The owners had both the responsibility and authority for paying Floppy Mop's bills.

• The owners had the sole responsibility for preparing and signing monthly remittance reports to the funds that reported the amount of work performed by covered employees and the amount of contributions owed to the funds and to pay the contributions owed.

While the immediate impact of the court's decision is to create liability for delinquent employer contributions against persons in addition to the contributing employer, there may be other consequences associated with plan language that provides for delinquent employer contributions to be considered plan assets. For example, contributing employers to a multiemployer fund generally do not have standing to bring an action under ERISA for breach of fiduciary with respect to a multiemployer fund. However, a fiduciary does possess standing to bring an action under ERISA for breach of fiduciary. As a result, a contributing employer that is considered to be a fiduciary may have standing under ERISA to bring an action against a multiemployer plan's trustees for breach of fiduciary duty. (*Trustees of the Construction Industry & Laborers Health & Welfare Trust v. Archie*, D. Nev., 2014)

Annual Withdrawal Liability Payments Calculated at Highest Contribution Rate for all Groups, Excludes Surcharge

Woodbridge Logistics, LLC was a contributing employer to a multiemployer pension fund prior to its withdrawal from the fund in February 2011. Woodbridge had been obligated to contribute to the fund under three collective bargaining agreements (CBAs). The CBAs required Woodbridge to contribute to the fund based on the number of hours worked by covered employees. The hourly contribution rates under the CBAs ranged from $1.50 to $3.69 per hour.

The Pension Protection Act of 2006 amended ERISA to impose a surcharge if a multiemployer plan is in critical status – meaning generally that the plan is less than 65 percent funded. For the first year the multiemployer plan is in critical status, the surcharge is equal to 5 percent of the contributions the employer is otherwise required to contribute under the

applicable CBA. In each succeeding year the plan remains in critical status, the surcharge percentage increases to 10 percent. At the time of Woodbridge's withdrawal, the fund had been in critical status for several years, meaning Woodbridge had been subject to the 10 percent surcharge.

The annual amount of a withdrawn employer's withdrawal liability payments is the product of:

1. The average annual number of contribution base units for the period of three consecutive plan years during the period of 10 consecutive plan years ending before the plan year in which the withdrawal occurs in which the number of contribution base units for which the employer had an obligation to contribute under the plan was the highest and

2. The highest contribution rate at which the employer had an obligation to contribute under the plan during the 10 plan years ending with the plan year in which the withdrawal occurs.

A contribution base unit is the unit with respect to which the employer is obligated to contribute to the multiemployer fund. In the case of Woodbridge, the contribution base unit was hours worked. An "obligation to contribute" generally means an obligation to contribute to a multiemployer fund that arises under a CBA or applicable labor-management law. Under ERISA, if an employer's withdrawal liability does not fully amortize after 20 years of annual payments, the employer's withdrawal liability is generally limited to the first 20 annual payments.

Following Woodbridge's withdrawal, the fund determined and then notified Woodbridge of the amount of its withdrawal liability and the schedule for payments. In calculating the amount of Woodbridge's annual payments, the fund (1) determined Woodbridge's highest contribution rate to be $3.69 per hour and (2) added the 10 percent surcharge to the contribution rate, thus determining Woodbridge's highest contribution rate to be $4.06. Woodbridge contested the propriety of both determinations, arguing (1) a blended rate should have been used to determine the highest contribution rate in order to reflect the fact that Woodbridge was obligated to contribute to fund at a range of rates and (2) the surcharge did not factor into the determination of the highest contribution rate because it did not arise under the CBAs or applicable labor-management laws. Importantly, Woodbridge's withdrawal liability did not fully amortize after 20 years under the fund's annual payment determination. Accordingly, any reduction in the highest contribution rate would result in direct savings for Woodbridge.

The district court first held that ERISA's use of "highest contribution rate" unambiguously means the highest rate at which the employer was required to contribute to the plan rather than a blended rate to reflect a range of contribution rates. As a result, the court upheld the fund's determination to use the $3.69 per hour amount to determine Woodbridge's annual withdrawal liability payment.

The court rejected, however, the fund's determination to also include the 10 percent surcharge in calculating Woodbridge's annual withdrawal liability payment. The court reasoned that the obligation to contribute for the 10 percent surcharge arose under ERISA, not under the CBAs or applicable labor-management law. Thus, the surcharge did not constitute an "obligation to contribute" as defined by ERISA.

As a result the court's holding, the highest contribution rate used to determine Woodbridge's annual withdrawal liability payments was decreased from $4.06 to $3.69. (*Bd. of Trustees of the IBT Local 863 Pension Fund v. C&S Wholesale Grocers, Inc., D.N.J., 2014*)

Unilateral Modification of Collectively Bargained Retiree Medical Benefits Leads to Litigation

The increasing and unpredictable costs of retiree medical benefits pose a significant threat to the financial health of employers who sponsor these plans, leading employers to consider various strategies for reducing or eliminating those costs. The strategies include restricting future eligibility for retiree health benefits, requiring greater retiree cost sharing, and eliminating retiree health benefit coverage altogether. A recent case, *Sloan v. BorgWarner*, Inc, illustrates the litigation hazards faced by employers who unilaterally modify retiree health benefits that are collectively bargained.

An employer's right to modify or terminate health benefits for retired employees is regulated by ERISA and, in the case of collectively bargained benefits, by the Labor Management Relations Act (LMRA). Importantly, neither ERISA nor the LMRA confers on retirees a statutory right to enjoy these benefits for life. In other words, neither ERISA nor the LMRA creates a statutory right to vesting for retiree medical benefits. But benefits may nevertheless vest by contract, that is, by the terms of the governing plan documents. Absent plan document provisions that vest retiree medical benefits, an employer may unilaterally modify or terminate retiree medical benefits. In the collectively bargained retiree health benefits context, courts will first look to the language of the collective bargaining agreement and other negotiated documents. If the collective bargaining agreement and related documents do not address vesting or are ambiguous, the courts will then look to other evidence of the parties' intent, including, for ERISA plans, the SPD. If the collective bargaining agreement unambiguously vests retirees in these benefits, a court may not consider any other evidence in determining the parties' intent. A court will not find that benefits are vested absent an affirmative showing of an intent to vest these benefits. The retiree (or union, in some cases) has the burden of proving an intent to vest.

In May 2009, BorgWarner closed one of its plants and unilaterally implemented modifications to the health care benefits of certain retirees and surviving spouses. Shortly thereafter, suit was filed on behalf of approximately 1,750 affected retirees and surviving spouses of retirees who retired from BorgWarner under a number of different collective bargaining agreements. The issue before the court was whether BorgWarner had contractually agreed to continue retiree benefits as provided under the terms of the collectively bargaining agreement once the agreement had terminated. If so, the unilateral changes implemented by BorgWarner would not have been permitted. In an effort to avoid a potentially long and costly trial, both parties asked the court to rule on the issue of vesting, based principally on the terms of the collective bargaining agreement and health insurance documents. The court ruled that these documents were ambiguous about the issue of vesting and that genuine issues of material fact exist on the question of the parties' intent to vest or not. As a result, the court declined to decide the issue of vesting and ordered that the matter proceed to trial. (*Sloan v. BorgWarner, Inc*., E.D. Mich. 2014)

Employers that maintain collectively bargained retiree medical benefits should not assume these benefits cannot be unilaterally modified or terminated. It is possible, based on the language of the collective bargaining agreement and related health care documents, that they can be. As noted above, neither ERISA nor the LMRA create a statutory right to vested, lifetime retiree medical benefits, and such benefits vest only by virtue of the terms of the collective bargaining agreement and governing plan documents. However, because litigation can ensue, as evidenced in *Sloan v. BorgWarner*, a decision to unilaterally modify or terminate retiree health benefits should be implemented only after all relevant facts and

circumstances have been carefully evaluated with the assistance of counsel. Where a collective bargaining agreement is silent or ambiguous, and extrinsic evidence of vesting is lacking, an employer may reasonably choose to unilaterally modify or terminate benefits if the consequences of continuing the coverage outweigh the costs of litigation. In some circumstances, employers in this situation might also consider seeking court approval of the right to unilaterally alter a retiree health insurance plan.

RULINGS, OPINIONS, ETC.

PBGC Adjusts Premium Due Date for Small Plans

Continuing its program to simplify premium payment filings, the Pension Benefit Guaranty Corporation (PBGC) adopted final Regulations regarding the premium due date for small plans. Under the new Regulation, the premium due date for small plans will be 9 1/2 months after the beginning of the premium payment year. This date will correspond with the premium due dates for mid- and large-size plans and also correspond with the extended due date for filing Form 5500. The Regulation would allow small plans that determine their data as of the end of the plan year the determination of the variable rate premium using information and assumptions for the prior premium payment year. Under existing rules, a small plan that operates on a calendar year would file its 2014 premium by February 15, 2015, and, under the new Regulation, for the 2015 year by October 15, 2015. This would create the financial burden of filing two premiums in a single year. Under the new Regulation, the plan could elect a four-month extension for the 2015 premium so that the time between premium payments is a little more equally spaced. Also, in case of financial hardship, a penalty waiver would effectively allow for an additional two-month extension. (PBGC Final Rule)

DOL Proposes Rules on 401(k) Fee Disclosure by Service Providers

Beginning in 2012, plan service providers, brokers, and recordkeepers were required to disclose information regarding certain fees they receive to fiduciaries of individual account plans. The Department of Labor (DOL) has been concerned that the documents being disclosed could be lengthy, complicated, and contained in more than one document. The DOL has proposed guidance to require that if disclosure documents meet certain requirements, such as use of multiple documents and lengthy document disclosures, that the party furnishing the disclosure must prepare a guide to allow fiduciaries to find certain information. (DOL Proposed Regulation §2550.408b-2)