EMPLOYEE BENEFITS DEVELOPMENTS SEPTEMBER 2014

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CASES

Post-Retirement Medical Benefits Under Siege. A recent spike in retiree benefit litigation is evidence of a growing interest among employers in strategies designed to contain, reduce, and eliminate the current costs and balance sheet liabilities associated with post-retirement medical obligations. In fact, one such case – *M&G Polymers USA, LLC v. Tackett* – has reached the U.S. Supreme Court. The causes of this renewed focus ostensibly include the protracted economic recession and the fact that retirees younger than 65 (pre-Medicare eligible retirees) have the option to purchase individual medical coverage through the Obamacare exchanges, potentially on a subsidized basis.

Unlike pension benefits, post-retirement medical benefits offered by private sector employers do not vest by operation of law. As a general rule, this means that an employer whose plan is governed by ERISA may reduce or eliminate these benefits at any time (with advance notice) and for any reason, subject only to any restrictions in the plan document terms that were in effect at the time of retirement. Governing plan documents include collective bargaining agreements and summary plan descriptions (SPDs). Employee communications, including verbal representations, regarding the amount and duration of retiree medical coverage can also restrict an employer's ability to reduce or terminate these benefits, even if the plan documents reserve the employer's right to do so.

Federal appeals courts have developed different interpretational standards for determining whether retiree medical benefits in collective bargaining agreements are vested. For example, in a recent case, *Windstream Corporation v. Da Gragnano*, the employer agreed "to provide retiree medical benefits for eligible employees who retire between March 1, 2005, and February 28, 2008 . . . and their beneficiaries." The collective bargaining agreement also specified the amount the employer "will" contribute toward the cost of coverage. In ruling that this language did not create a vested right to lifetime medical benefits, the U.S. Court of Appeals for the Eighth Circuit, located in Missouri, said the following:

> The only vesting language [the retiree] points to in the plan documents here is the word "will" before the words "pay a percentage/amount of the premium" in

Attorneys

Peter Bradley

Michael Flanagan

Richard Kaiser

Ryan Murphy

Practices & Industries

Employee Benefits

> the 2005 MOA. [The retiree] and the CWA assert that this word shows that the company intended to provide the retiree benefit subsidy for the lifetimes of the retirees. When placed in front of a verb like "pay," the word "will" indicates "simple futurity," "likelihood or certainty," "requirement or command," "intention," "customary or habitual action," "capacity or ability," and "probability or expectation." *Webster's II New College Dictionary* (3d ed. 2005). *None of these definitions promise that the verb will be performed permanently. Actions that are likely, certain, required, commanded, customary, or habitual may be expected one day to end. [emphasis added]*

It is very possible that a federal appeals court sitting in New York or Ohio, for example, would have ruled that such language, without more, is sufficient to create a vested right to retiree medical benefits.

The Supreme Court's decision in *M&G Polymers USA, LLC v. Tackett*, expected in the first few months of 2015, will resolve at least some of the differences in the interpretational standards that the federal appeals courts in the various circuits apply in determining whether an employer has the right to unilaterally reduce or terminate retiree medical obligations in collective bargaining agreements.

As *Windstream* instructs, 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. However, because litigation can ensue, 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.

$800,000 Settlement in HIPAA Breach Case. The Department of Health and Human Services (HHS) entered into a resolution agreement with a health care provider regarding an alleged breach of the Health Insurance Portability and Accountability Act's (HIPAA's) privacy rule. Under HIPAA's privacy rule, covered entities, such as health care providers and group health plans, are required to appropriately and reasonably safeguard protected health information in their possession. The complaint filed with HHS alleges the covered entity failed to meet this standard by leaving 71 cardboard boxes of medical records unattended on a retiring practitioner's driveway 20 feet from a public road and a short distance from a popular shopping area. While this allegation and settlement amount are sensational, this situation serves as a reminder that covered entities should adopt and follow policies to secure the protected health information of patients and plan participants. Often these cases involve electronic transmission of data but, as this case illustrates, severe penalties also apply to the mishandling of paper documents. (HHS News Release – Parkview Health System, Inc., June 2014)

First Circuit Upholds Use of Retained Asset Accounts to Pay Life Insurance Benefits. Joining the Court of Appeals for the Second and Third Circuits, the Court of Appeals for the First Circuit issued a recent ruling that approves the use of retained asset accounts (RAAs) as a mechanism for paying death benefits under an ERISA group life insurance plan. The insurer used a bank to administer the RAAs and credited to each plaintiff's RAA the full amount of the death benefits owed. The insurer mailed books of drafts to the plaintiffs that allowed the plaintiffs to withdraw all or any part of their RAAs. While the plaintiffs were able to liquidate and close their RAAs relatively quickly, there was a period during which the insurer retained the credited funds in its general account and paid the plaintiffs interest at a rate of one percent. The plaintiffs allege the one percent rate was substantially less than the return the insurer earned on its portfolio.

Beneficiaries of group life insurance policies provided by Unum brought a class action in which they alleged the insurer violated ERISA's rules that prohibit the insurer from dealing with plan assets for its own interest and breached its duty of loyalty to the beneficiaries. At the district court level, the court ruled in favor of the insurer on the self-dealing claim and held that the insurer's use of RAAs in the circumstances of this case did not constitute self-dealing in plan assets. But the district court ruled in favor of the plaintiffs on the duty of loyalty claim and awarded class-wide relief totaling more than $12 million. Both sides appealed. On appeal, the First Circuit not only ruled that the insurer's use of RAAs in the circumstances of this case did not constitute self-dealing in plan assets but also held that the insurer's use of RAAs did not breach any duty of loyalty owed by the insurer to the beneficiaries.

With respect to the self-dealing claim, the court held that "the funds backing the plaintiffs' RAAs were not, and never became, plan assets." In so ruling, the court rejected the beneficiaries' argument that once a death benefit accrues and is redeemed via the establishment of an RAA, the RAA funds become plan assets if they are retained in the insurer's general account. And, in the absence of "plan assets," the court found there were insufficient grounds to support a self-dealing claim.

With respect to the duty of loyalty claim, the insurer argued that it had fully discharged its fiduciary duties by establishing the RAAs in accordance with the plan documents. Once the RAAs were established, the insurer argued, the relationship between the insurer and the beneficiaries was transformed to a debtor-creditor relationship, one in which the insurer was no longer acting as an ERISA fiduciary. The court held that "[t]he insurer's position makes sense, and it is bulwarked by relevant authority." The court rejected the beneficiaries' arguments that the insurer continued to act as a fiduciary even after it established the RAAs because it continued to hold the proceeds from the policies in its general account and that the insurer acted as a fiduciary in setting the interest rate because the plan documents stipulated no specific interest rate. *Merrimon, et al. v. Unum Life Insurance Company of America* (1st Cir. 2014)

No Actuarial Increase Required for Benefit Payments Suspended Due to Late Retirement. A recent decision by the U.S. Court of Appeals for the Sixth Circuit demonstrates the importance of using "unambiguous" language to describe pension benefits in retirement plan documents. Upholding a lower court decision, the Sixth Circuit ruled that American Airlines did not violate federal law when it declined to provide an actuarial increase in the deferred pension benefits for a pilot who elected to keep flying past age 60. Federal law permits qualified retirement plans to suspend the payment of accrued pension benefits for employees who defer retirement and continue working past their normal retirement age. The general rule is that retirees must be compensated by way of an increase in benefits for any deferral of pension payments. However, Department of the Treasury regulations provide an exception to the actuarial adjustment rule for employees who continue working after normal retirement age. To avoid violation of ERISA, the retirement plan documents must provide for the suspension of benefits *before* plan participants accrue the benefits at issue. In this case, the lower court examined the relevant plan documents and concluded the plan always prohibited participants from receiving pension benefits while actively employed by the company. Even though the plan did not label its late-retirement provisions "in so many words," the court found that it properly provided for the suspension of retirement benefits for pilots who continue flying after reaching age 60. Because the plan provided for the suspension of benefits before the pilot in this case began accruing benefits in 1989, the plan was not required to compensate him for the deferral of benefit payments with an actuarial increase in those benefits. The Sixth Circuit agreed with the lower court and upheld the grant of summary judgment in favor of the plan.

In a point of clarification, the appeals court also addressed the pilot's reliance on a series of SPDs that the airline furnished to its pilots. Citing the U.S. Supreme Court's 2011 conclusion in *CIGNA Corp. v. Amara* that, while SPDs provide "clear, simple communication" about a plan, SPD statements are not legally binding plan terms themselves, the appeals court found that the pilot "may not rely on the contents of SPDs to circumscribe or nullify the plain terms of the plan itself." Thus, although the district court determined the pilot's reliance on the SPDs was "unpersuasive in the first instance," the appeals court found the lower court was not even required to consider those arguments in light of the plan's "otherwise unambiguous late retirement provisions." *Canada v. Am. Airlines, Inc.* (6th Circ. 2014)

Delinquent Employer Contributions Not Considered Plan Assets. As discussed in our May 2014 *Employee Benefits Developments*, employer contributions owed to an ERISA plan (other than amounts withheld from employees' pay) generally do not become plan assets until they are actually contributed to the relevant plan. A line of cases has created an important exception to this general rule in situations where the plan document provides that delinquent employer contributions constitute plan assets as of the due date for those contributions. Under this exception, a person who fails to timely transmit employer contributions to a plan may be viewed as a fiduciary and, thus, potentially liable for breach of fiduciary duty.

H.B. Stubbs was a contributing employer to several multiemployer funds. The company experienced a period of economic hardship during which it failed to make over $500,000 in contributions to the multiemployer funds. Ultimately, H.B. Stubbs was left with no choice but to begin winding up its affairs.

In view of H.B. Stubbs' financial condition, the multiemployer funds' trustees filed an action against the company's officers, alleging they breached their fiduciary duties by failing to transmit the delinquent contributions to the respective funds. In making this allegation, the funds failed to cite any plan document provision providing that employer contributions became plan assets at the time they became due and owing to the fund.

After reviewing the relevant case law, the district court joined those prior courts that held that, absent a plan provision to the contrary, employer contributions do not become plan assets until the required contribution is actually made to the plan. In the present case, since the trustees could not point to any plan provision that treated delinquent contributions as plan assets, the unpaid employer contributions were not considered plan assets. As a result, H.B. Stubbs' officers were not considered fiduciaries who could be personally liable for the unpaid contributions.

It is recommended that employers that are obligated to contribute to a multiemployer fund review the underlying plan documents to determine whether those documents treat delinquent contributions as plan assets. Those who have authority and responsibility for determining which of the employer's creditors is paid may be surprised to learn that they may be personally liable to a multiemployer fund if contributions are not made to the fund in a timely manner by the employer. *Trustees of Michigan Regional Council of Carpenters' Employee Benefits Fund v. H.B. Stubbs Co.* (E.D. Mich. July 17, 2014)

RULINGS, OPINIONS, ETC.

IRS Finalizes Regulations to Allow Purchase of Longevity Annuity Contracts in Defined Contribution Plans. The IRS issued final regulations modifying the minimum distribution rules to allow for the purchase of deferred annuities that commence after age 70½, usually at age 80 to as late as age 85. The purpose of the regulation is to allow retirees to use a lifetime income option in a defined contribution plan to protect against the risk of outliving their retirement savings. Under the regulations, an individual could use a portion of his or her account balance to purchase an annuity while retaining the remainder for more traditional liquid-type investments in their account. The regulation applies to account-based plans, such as 401(a), 401(k), individual retirement annuities and accounts (IRAs), and governmental section 457(b) plans. The amount the individual can use to purchase a longevity annuity contract is the lesser of 25 percent of the account balance or $125,000. The $125,000 limitation will be adjusted for inflation in $10,000 increments. The regulation, which contains restrictions on the terms of the longevity contract, does allow for a "return of premium" feature, which would return all or a portion of the premium paid if the individual dies before or shortly after annuity payments commence. (TD 9673, 79 Fed. Reg. 37633)

IRS Withdraws 1981 Proposed Regulation on Rollovers From IRAs. In the April 2014 *Employee Benefits Developments*, we reported on the tax court decision in *Bobrow v. Commissioner* (T.C. Memo. 2014-21), in which the tax court ruled on the "one-year look-back rollover limitation" and held that an individual may not make an IRA-to-IRA rollover if he or she made such a rollover involving *any* of the individual's IRAs in the preceding one-year period. For many years prior to the *Bobrow* ruling, taxpayers believed the "one-year look-back rollover limitation" applied on an IRA-by-IRA basis. That understanding was in part based on proposed regulation section 1.408-4(b)(4)(ii), which was published in 1981. Because the IRS announced its intent to follow the opinion in *Bobrow*, the IRS, as promised, has now formally withdrawn proposed regulation section 1.408-4(b)(4)(ii). For any rollover that involves an IRA distribution occurring before January 1, 2015, however, the IRS is continuing to provide transitional relief and will not apply the *Bobrow* interpretation of the one-rollover-per-year limit. (79 FR 40031)