EMPLOYEE BENEFITS DEVELOPMENTS, FEBRUARY 2015

Hodgson Russ Newsletter
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ERISA § 4062(e) Liability Enforcement Returns--Applicable to Defined Benefit Plans and Succession of Operations at Facility. The Employee Retirement Income Security Act of 1974 (ERISA) § 4062(e) originally imposed liability when there was a cessation of operations at a facility and more than 20 percent of the employees covered by the employer's defined benefit plan lost their employment. Because the prior law provided for a very large liability amount, the Pension Benefit Guaranty Corporation (PBGC) in 2012 adopted an enforcement policy under which the PBGC would not enforce the liability in cases where there were fewer than 100 participants in the defined benefit plan or the employer was financially sound. Reflecting similar concerns in 2014, the PBGC announced a moratorium on all enforcement until the end of 2014.

As part of the Consolidated and Further Continuing Appropriations Act of 2015, ERISA § 4062(e) was amended. Because of that amendment, the PBGC published a notice in which it announced it is ending its moratorium on enforcement, is examining the provisions of the amended law, and will provide further guidance and information as appropriate. In the notice, the PBGC provided a short explanation of the provisions of amended ERISA § 4062(e), which included the following:

- Consistent with the PBGC 2012 enforcement policy, plans with fewer than 100 participants are exempt from liability.
- If the defined benefit plan is better than 90 percent funded, determined on the method used for purposes of paying PBGC premiums, there is also an exemption.
- Liability is triggered when the cessation of operation results in more than a 15 percent reduction in the total number of employees that participate in any employee plan, including defined contributions and 401(k) plans. This is a major change from prior law, which only looked at those employees covered under the defined benefit plan.
- The liability generally does not have to be paid as quickly as under prior law. If liability exists, the employer may contribute to the plan, in seven annual installments, an amount equal to one-seventh of the unfunded vested benefits multiplied by the percentage reduction in active participants.
- The PBGC will continue its prior enforcement policy, which means it will not enforce the liability against employers that are financially sound.

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- No reporting is required if the plan is exempt under the fewer-than-100-participants rule or the better than 90 percent-funded rule.

The provisions of the new law apply to cessation of operations occurring on or after December 16, 2014. PBGC Important Changes to ERISA Section 4062(e), http://www.pbgc.gov/about/faq/pg/important-changes-to-erisa-section-4062(e).html

Another Church Plan Decision in Favor of Church Plan Opponents. In a recent decision handed down by the U.S. District Court for the Northern District of Illinois, the court ruled that a pension plan maintained by a health care system that is affiliated with two Christian denominations is not a church plan within the meaning of ERISA, because the plan was not established by a church. *Stapleton v. Advocate Health Care Network & Subsidiaries (N.D. Ill., December 2014)*. The decision by the Illinois federal district court is consistent with two prior decisions handed down by federal district courts in California and New Jersey. *Rollins v. Dignity Health, (N.D. Ca. 2013) and; Kaplan v. St. Peter's Health Care Sys. (D.N.J., 2014)*. On the other hand, federal district courts in Michigan and Colorado have ruled that pension plans established and maintained by religiously affiliated employers can qualify as church plans. *Overall v. Ascension Health (E.D., Mich. 2014; Medina v. Catholic Health Initiatives (D. Colo. 2014)*. Just a few days ago, a federal district court in Maryland sided with Trinity Health Corporation, ruling that an organization associated with a church can establish a church plan. *Lann v. Trinity Health Corp.*, (D. Md., 2015). The decisional law is now even at three for and three against.

"Church Plan" Defined

The requirements of ERISA do not apply to employee benefit plans that qualify as "church plans" within the meaning of the statute.

Employers that sponsor church plans, and the employees who manage and administer them, are not required to comply with ERISA's fiduciary standards; maintain ERISA-compliant plan documents and summary plan descriptions (SPDs); file annual reports (5500s) with the Office of the Secretary of Labor (5500s); distribute summary annual reports; or resolve denied benefit claims in accordance with ERISA claims and appeal procedures.

In addition, an employer that maintains a defined benefit pension plan that qualifies as a church plan is not required to ensure that the plan is funded in accordance with ERISA's funding standard. It is this requirement—ERISA's funding requirement—that has fueled the controversy as the pension plans at issue in these cases are allegedly underfunded.

An employee benefit plan is a church plan if the plan is *established* and *maintained*:

- By a church, which is exempt from tax under section 501 of the Internal Revenue Code,

- For the benefit of employees of the church.

Employees of an employer that is exempt from tax under section 501 of the Internal Revenue Code are deemed to be church employees if the employer is *controlled by* or *associated with* a church. An employer is "associated with" a church if it shares common religious bonds and convictions with that church.

Importantly, ERISA provides that a plan *established* and *maintained* by a church includes a plan *maintained* by an organization that is not a church if two requirements are satisfied:

- The organization has, as its principle purpose or function, the administration or funding of a plan for the employees of a church or a convention or association of churches; and
- The organization is controlled by or associated with a church.

In a long line of letter rulings, the IRS has consistently taken the position that a plan maintained by a religiously affiliated employer, like Advocate Health Care Network (Advocate), can qualify as a church plan under this ERISA provision so long as the plan is administered by an organization (e.g., a committee or trust) that is controlled by the religiously affiliated employer that sponsors the plan.

The Complaint Against Advocate Health Care Network

In this case, current and former employees of Advocate sued, alleging that Advocate has not funded and otherwise maintained its defined benefit pension plan according to ERISA standards. Advocate operates 12 hospitals and more than 250 other inpatient and outpatient healthcare locations across northern and central Illinois, and was formed in 1995 as a 501(c)(3) non-profit corporation. Advocate is affiliated with the United Church of Christ and the Evangelical Lutheran Church in America, but is not owned by either church. The pension plan at issue was established by Advocate, which does not claim to be a church.

The Court's Ruling in Advocate

The court's ruling, if not its rationale, it easy to articulate: The pension plan maintained by Advocate is not a church plan because a plan cannot be a church plan under ERISA's definition unless it is *established* by a church and Advocate, the entity that established the plan, is not a church.

The court rejected Advocate's argument that a plan *maintained* by an organization that is not a church can qualify as a church plan if the organization is associated with a church. In the court's view, the fact that a religiously affiliated, non-church entity can *maintain* a church plan does not override the requirement that the plan be *established* by a church.

As noted, the court's construction of the statute is at odds with countless DOL advisory opinions and IRS private letter rulings and three recent federal district court rulings that have extended church plan status to plans *established* by employers that were not themselves churches, if the organization that established the plan was associated with a church.

Conclusion

Religiously affiliated employers that sponsor church plans should stay abreast of developments in the church plan case law, and should consider conducting a careful review of their plans to identify the issues that would arise if the law resolves in favor of the interpretation adopted by the court in Advocate which, as noted, has been adopted by two other courts. If an employer has an IRS letter ruling or DOL advisory opinion confirming the church plan status of the employer's plans, the employer should be sure that its plans are structured and administered in strict compliance with the facts represented in the letter ruling or advisory opinion. Church plan sponsors that have not obtained a ruling from the IRS or DOL should review the applicable guidance and make any necessary modifications to the structure and operation of the plans.

COBRA Notice Failure Is a Fiduciary Breach. The U.S. District Court for the District of Maryland recently granted summary judgment to two plaintiffs who claimed their former employer breached its fiduciary duty by failing to provide timely COBRA notices. In this case, the plaintiffs were suspended without pay for a period of several months prior to the termination of their employment. Although their health plan coverage continued during their suspension, the employer ceased subsidizing the cost of their monthly premiums. The employer did not notify the plaintiffs that they were responsible for the full cost of their health insurance premiums. Several months later, when the plaintiffs were ultimately terminated and COBRA notices were furnished, the plaintiffs were given invoices for the full cost of coverage provided during their suspensions. Under the COBRA regulations, a plan administrator generally must notify qualified beneficiaries of their COBRA rights within 44 days of a qualifying event, such as a termination of employment or a reduction of hours that results in a loss of coverage. Here, the plaintiffs incurred a qualifying event when they were suspended because their hours were reduced to zero. Furthermore, the COBRA regulations broadly define a "loss of coverage" to include "any increase in the premium contribution that must be paid by a covered employee…." As such, the court ruled that the plan administrator breached its fiduciary duty by not providing the plaintiffs with their COBRA notices within 44 days from the date they were suspended and required to pay more to maintain their health coverage. The court granted the plaintiffs' motion for summary judgment and declared that all invoices for coverage provided to plaintiffs during the period of their suspension were null and void. To avoid making similar errors, plan administrators should take a moment to review their leave of absence procedures to ensure that they are properly coordinated with their COBRA notice obligations. *Green v. Balt. City Bd. Of Sch. Comm'rs* (D. Md., 2015)

State Law Claims to Survivor Benefits Preempted by ERISA. Affirming a lower court decision, the U.S. Court of Appeals for the D.C. Circuit ruled that a pension plan participant may not use a Texas state law to strip his ex-wife of her vested interest in a survivor annuity under the plan. Sometime prior to his retirement, the participant in this case designated his wife as the beneficiary of a 100-percent qualified joint and survivor annuity in his company pension plan benefit. On his retirement in 1994, the participant began receiving monthly retirement benefits under the plan, and the survivor annuity irrevocably vested in his wife. When the parties divorced eight years later, the divorce decree awarded the husband all rights in his pension plan. One year later he remarried and sought to designate his new wife as the survivor annuity beneficiary. Despite the objections of his first wife, who argued that she had consented to the divorce decree only because she believed that the survivor annuity was her separate property, the state court entered a qualified domestic relations order (QDRO) divesting the first wife of all ownership interests in the survivor annuity. To prevent the order from requiring increased benefits beyond the original actuarial estimates, the annuity benefits would continue to be based upon the first wife's life expectancy.

In 2005, the company terminated its pension plan and the Pension Benefit Guaranty Corporation (PBGC) became the plan's trustee. As part of its independent review of plan benefits, the PBGC determined that the purported QDRO was invalid and that the first wife was the proper beneficiary of the survivor annuity. The PBGC determined that the order was not a valid QDRO because it would require the plan to provide a hybrid form of benefit not otherwise provided under the plan—that is, an annuity for the duration of the second wife's life, rather than for the first wife's life. Second, the PBGC determined that ERISA mandated that the first wife's right to the survivor annuity irrevocably vested on the day the participant retired, unless she waived that right within 90 days of the annuity start date. Since she had not waived her rights, the state court order could not transfer her right to the survivor benefit to the new wife.

Following a failed administrative appeal, the participant filed suit in district court, seeking to overturn the PBGC decision. The participant also brought a state law claim that, in any event, he had equitable title to the survivor benefits under Texas law and that any payments his first wife might receive under the annuity must be held in constructive trust for distribution in accordance with his wishes. The district court ruled in favor of the first wife, finding that the PBGC decision was both reasonable and amply supported by the administrative record and that the state-law claims were preempted by ERISA. The court emphasized that the claims were "nothing more than an effort to make an end-run around ERISA's statutory prescription" and would permit the participant "to achieve what [he] otherwise cannot accomplish under the statute itself – to divest [his first wife] of the survivor annuity benefit paid to her by PBGC."

On appeal, the participant moved to dismiss PBGC from the case, effectively conceding that under ERISA, the survivor annuity belongs to his first wife. Focusing his appeal on the state-law claims, the participant sought a declaration that any survivor benefit payments his first wife might receive must be held in a constructive trust, to be assigned to a different beneficiary of his choosing. Noting that "this case involves an effort by a plan participant to obtain an interest in *undistributed* plan benefits," the D.C. Circuit held that, absent a QDRO and compliance with ERISA's strict waiver provisions for survivor annuities, the participant may not use state law for that purpose. In affirming the decision of the lower court, however, the D.C. Circuit also stressed that the opinion does not address "how ERISA might affect an effort by a plan participant to use state law to obtain an interest in benefits after distribution to the beneficiary." *Vanderkam v. Vanderkam* (D.C. Cir. 2015)

Ninth Circuit: Beneficiary Designation Forms Were Not "Plan Documents." Reversing a district court summary judgment, the U.S. Court of Appeals for the Ninth Circuit held that beneficiary designation forms were not "plan documents" governing the plan administrator's award of ERISA plan benefits. The case involved a retiree who was covered by his former employer's ERISA plans. When he retired, his spouse was his designated beneficiary. Following his divorce in 2006, the retiree attempted to change his beneficiary designation from his ex-wife to his son from an earlier marriage. He did so by contacting the employer telephonically on multiple occasions between July 2007 and January 2011, and indicating to the employer that he wanted his son to be his beneficiary.

Following each telephone conversation with his former employer, the retiree received, but did not sign and return, beneficiary designation forms requesting that he confirm his selection of his son as beneficiary. The retiree died in 2011, after which his son and the spouse who he divorced in 2006 each contacted the employer to assert claims for the death benefits payable under the ERISA plans. The fiduciaries for the plans did not resolve the competing claims for the death benefits, and instead interpleaded the ex-wife and the son (i.e., requested a judicial determination) in federal district court. The ex-wife moved for summary judgment, arguing that because the participant (i.e., her ex-husband) had failed to return the completed designation forms and did not properly designate the son as the beneficiary. The district court granted the ex-wife's motion for summary judgment. The son appealed that decision.

In granting summary judgment in favor of the ex-wife, the district court concluded that the beneficiary designation forms were "plan documents" that the participant/retiree needed to sign and return to effectuate a change to his beneficiary designation. The Ninth Circuit disagreed and reversed the district court's summary judgment. The court held that because beneficiary forms do not "provide information as to where the participant stands with respect to the plan" (instead, "they simply confirm the participant's attempt to change his designated beneficiary"), those forms are not "plan documents"

governing an award of benefits under the plan. The Ninth Circuit also pointed out that none of the actual plan documents incorporate the beneficiary designation forms by reference.

In its ruling, the Ninth Circuit also rejected the ex-wife's argument that the plan administrator for the ERISA plans exercised discretion by sending the beneficiary designation forms to the participant/retiree, and was within its authority to require their use. The court held that the plan administrator for each plan, by filing the interpleader action, effectively declined to exercise any discretion in determining whether the retiree's telephonic designation of his son as beneficiary was valid under the plan.

Because there apparently was nothing explicit in the governing plan documents preventing *unmarried* participants from designating beneficiaries by telephone call, and because the summary plan descriptions for both plans instruct *unmarried* participants to call the plan sponsor or to visit the plan sponsor's website to change or complete a beneficiary designation, and because the plan documents did not specifically require any sort of written designation for *unmarried* participants, the court concluded that a reasonable trier of fact could determine that the participant/retiree intended to change his beneficiary to his son, and that his phone calls to the plan sponsor constituted substantial compliance with the governing plan documents' requirements for changing his beneficiary designation. For those reasons, the court did not uphold the district court's grant of summary judgment for the ex-wife. *Becker v. Williams* (9th Cir. 2015)

PBGC Position on Post-Termination PPA Amendments Upheld. The Pension Protection Act of 2006 (PPA) amended the actuarial assumptions that may be used by a qualified retirement plan in calculating the minimum present value of a participant's benefit under a plan. The revised actuarial assumptions could result in smaller lump sum distributions to participants than would have been made under the pre-PPA rules. As a result, the PPA provided relief from the anti-cutback rule that exists under both ERISA and the Internal Revenue Code if certain conditions were met.

In two recent cases, employers sponsoring qualified pension plans terminated the pension plans as of a date before the plans were amended to include the revised PPA actuarial assumptions. In each instance, the plan was amended for the PPA within months after the termination date selected by the plan sponsor, but before plan benefits were distributed to participants. When plan benefits were distributed upon the plans' termination, the PPA actuarial assumptions were used for lump sum distributions.

The Pension Benefit Guaranty Corporation (PBGC) determined that the use of the PPA actuarial assumptions violated its regulations relating to the termination of single-employer pension plans. Specifically, the PBGC determined that use of the PPA actuarial assumptions violated its rule that a participant's benefits are determined under the plan provisions in effect on the plan's termination date, except that a post-termination amendment that does not decrease a participant's benefit may be given effect. Under its rule, the PBGC determined that the plans had not been amended for the PPA as of their termination date and, since the PPA amendments resulted in a decrease in participants' plan benefits, the amendments would not be given effect. Thus, participants who elected to receive benefits in the form of a lump sum distribution were entitled to additional amounts from the plan sponsors.

On judicial review, the plan sponsors argued that an exception under the PBGC's rule for post-termination amendments that are required to maintain a plan's qualified tax status allowed the PPA amendment to be effective. The courts disagreed, holding that while the PPA permitted the plan amendments, there was nothing that prohibited the plans from providing

greater benefits and, therefore, the decrease was not necessary to maintain the plans' qualified tax status.

In one of the cases, the plan sponsor also argued that, because the PPA amendment was made effective as of a date before the plan termination date, the amendment was part of the plan as of the plan termination date. The court rejected this argument, holding that the PBGC's interpretation of its regulation that an amendment must actually be adopted before the plan's termination date was not arbitrary or capricious and, therefore, was entitled to judicial deference. *Pension Benefit Guaranty Corp. v. Kentucky Bancshares, Inc.* (6th Cir. 2015); *Royal Oak Enterprises, LLC v. Pension Benefit Guaranty Corp.* (D.D.C. 2015)