Hodgson Russ LLP ATTORNEYS

EMPLOYEE BENEFITS DEVELOPMENTS JULY 2015

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Attorneys

Peter Bradley

Michael Flanagan

Richard Kaiser

Ryan Murphy

Practices & Industries

Employee Benefits

CASES

Second Circuit Holds That Posthumous QDROs Are Valid. Yale-New Haven Hospital brought an action in federal court to resolve competing claims by a former spouse of a deceased participant and the deceased participant's surviving spouse to death benefits payable under the terms of the retirement plans in which the deceased was a participant. The participant's surviving spouse claimed entitlement to the death benefits as the participant's beneficiary. The former spouse contended, among other things, that a portion of those funds were payable to her pursuant to the terms of two domestic relations orders entered after the participant's death. The surviving spouse argued that the two orders were not valid QDROs because they were entered after the death of the participant and effected a reassignment of vested plan benefits from the surviving spouse and sole designated beneficiary — to the former spouse, in contravention of ERISA. In a split decision (2-1), the court agreed with the former spouse, holding that the domestic relations orders entered after the death of the participant were valid QDROs that entitled the former spouse to survivor benefits from three of the four retirement plans at issue. The sole dissenting judge, while acknowledging that posthumous domestic relations orders *can* serve as QDROs, noted that nothing in the record established that the plan administrator was on notice of the domestic relations orders before the participant's death. According to the dissenting judge, permitting a former spouse's posthumous orders to deny a surviving spouse her survivor benefits when there was no pre-death notice of the competing interest would undermine ERISA's statutory scheme. In this case, the death benefits presumptively owed to the named beneficiary were not in pay status when the QDROs were received, affording the plan administrator the opportunity to petition the court for an order directing the distribution of the death benefits. The holding raises the following questions that employers may wish to discuss with their benefits counsel: 1) what should a plan administrator do if it distributes death benefits to a named beneficiary and later receives a QDRO that awards some or all of the already-distributed benefits to a former spouse, and 2) what measures can it take to prevent that scenario from unfolding? *Yale-New Haven Hosp. v. Nicholls*, 2d Cir., 2015

Deferred Bonus Plan Not Covered Under ERISA. A sales person in the financial industry left one job for another. A part of his compensation package with the new employer was a deferred bonus plan. Under the plan, bonus amounts earned in year one were partly paid in the following year, and the remainder was paid over the course of the years three, four, and five in the form of cash and stock units. The employment relationship with the new employer did not work out; the sales person filed a suit claiming that parts of the compensation package that he had been promised at time of hiring had not been received. As part of this action, he also filed claims seeking relief under the Employee Retirement Income Security Act of 1974 (ERISA), arguing that the deferred bonus plan was a plan covered by ERISA. The defendant-employer moved to dismiss the ERISA claims, arguing that the deferred bonus plan was not covered under ERISA. The district court found that ERISA specifically exempts from coverage a bonus plan unless it systematically defers compensation to retirement or termination of employment. The court reviewed the deferred bonus plan structure and found that payment over a period of years following the year in which the bonus was earned does not defer the compensation to termination of employment or retirement. Further, the court rejected the argument that the period of years could, in some situations, extend to a person's termination or retirement. The court rejected this argument, finding that the plan did not do this in a systematic manner. Therefore, the court dismissed the ERISA claim but allowed the other claims not under ERISA to proceed. *Forte v. BNP Paribas*, S.D.N.Y., 2015

Courts Disagree on Denial Letter SOL Disclosures. A statute of limitation provision generally prevents an individual from pursuing a claim after a certain period of time has passed. ERISA does not contain a statute of limitation provision for claims challenging benefit denials. In the absence of such a provision, courts typically borrow from the most closely analogous state limitations period. However, under certain circumstances, courts will enforce a statute of limitation provision that is included as part of an ERISA plan document. To be enforced, such "contractual statute of limitation" provision must be deemed reasonable. Furthermore, in some jurisdictions, the benefit denial letter must include notice of the statute of limitation for it to be effective. This was the situation recently in the U.S. Court of Appeals for the Sixth Circuit, where a plaintiff successfully appealed a prior ruling that barred her long-term disability claim. The Sixth Circuit held that the contractual statute of limitations provision found in the plan did not bar her claim because notice of the limit was not included in her claim denial letter. In contrast, the Eleventh Circuit recently enforced a contractual statute of limitation period even though it was not disclosed in the plaintiff's claim denial letter. In that case, the court noted that ERISA does not explicitly require notice of the time limit to be included in the claim denial letter. Instead, the court stated that the contractual limitations period was enforceable unless the plaintiff could establish that there were extraordinary circumstances and that she diligently pursued her rights. The fact that the claim denial letter did not put her on notice of the contractual statute of limitation did not render such time limit ineffective. In an effort to protect their plans from untimely lawsuits, plan sponsors should not only consider including reasonable statute of limitation provisions in their plan documents; they should also consider including notice of such provisions in their claim denial letters. *Russell v. Catholic Healthcare Partners Emp. Long Term Disability Plan*, 6th Cir.; *Wilson v. Standard Ins. Co.*, 11th Cir.

Release Requirement in Severance Plan Does Not Affect ERISA Preemption. Upholding a lower court decision, the U.S. Court of Appeals for the Ninth Circuit held that a former executive's breach of contract claim against his employer in connection with the company's executive severance plan is pre-empted by ERISA. The executive had argued that the severance program is not an employee benefit plan under ERISA, because ERISA is "not designed" to cover corporate programs that require a release of claims to receive benefits, and because there was "no discretion" involved in determining eligibility under the program. According to the executive, the plan simply offers a lump-sum payment in exchange for a

release. Rejecting the executive's argument, the court held that ERISA plans may require an employee to execute a release of claims to qualify for and receive plan benefits. The court also disagreed with the executive's contention that the severance plan did not require enough administrative discretion to qualify the program as an ERISA plan. Noting that "ample discretionary decisions" are made on eligibility, disqualification, adjustments in awards, interpretation of terms, and a claims procedure, the court held that the discretionary decisions required to administer the plan exceed the level required for a severance program to qualify as an ERISA plan. Accordingly, the court rejected the executive's claim as pre-empted by ERISA. *Edwards v. Lockheed Martin Corp.*, 9th Cir., 2015

Stock Drop Litigation Update: Lawsuit Dismissed for Failure to Meet Post-*Dudenhoeffer* Pleading Standards. Former HP employees and participants filed a lawsuit alleging that various investment managers and HP executives breached their ERISA fiduciary duties with respect to HP stock held by the HP Company 401(k) Savings Plan (the Plan) when they failed to disclose material information about problems with an $11.1 billion acquisition of Autonomy, Inc. in 2011. Plaintiffs purchased HP stock through the Plan, and alleged that they suffered losses from purchasing and holding HP stock, rather than purchasing or diversifying into other investment options under the Plan. In April 2014, a federal district court granted the Plan fiduciaries' motion to dismiss the plaintiffs' complaint on the grounds that a presumption of prudence applies and that it was not improper for the Plan fiduciaries to take the time to investigate prior to making any disclosures. In June 2014, the Supreme Court's decision in *Fifth Third Bancorp v. Dudenhoeffer* abrogated the presumption of prudence and articulated new pleading standards for fiduciary breach cases involving employer stock. After the *Dudenhoeffer* decision, the plaintiffs in the HP case filed an amended complaint. Because the plaintiffs failed to allege facts sufficient to state a claim, the court once again granted the Plan fiduciaries' motion to dismiss the amended complaint.

The amended complaint filed by the plaintiffs alleged the Plan fiduciaries violated their ERISA duties "by engaging in an illegal scheme to conceal material facts about Autonomy's improper accounting practices in that they failed to freeze new investments" in HP stock, "and/or failed to disclose complete and accurate information to Plan participants despite knowing that HP stock had become artificially inflated in value." The amended complaint also alleged that "[r]ather than come clean about what it had learned about Autonomy's accounting practices…HP attempted to 'unwind' these accounting improprieties in secret."

Under the standards announced in the *Dudenhoeffer* decision, a plaintiff states a claim for breach of the duty of prudence on the basis of inside information if the plaintiff can "plausibly allege an alternative action that the defendant could have taken that would have been consistent with the securities laws and that a prudent fiduciary in the same circumstances would not have viewed as more likely to harm the fund than to help it." The court ruled that the amended complaint failed to allege facts sufficient to satisfy the key elements of the *Dudenhoeffer* pleading standards. The court found the "alternative actions" alleged by plaintiffs (i.e., restricting investments in HP stock and publicly disclosing the attempts to hide or conceal material adverse facts about Autonomy's improper accounting practices) were not plausible because it would have been inconsistent with the disclosure regime of the securities laws to require HP "to disclose in real time any suspicions or allegations about Autonomy that are yet uninvestigated." The court also ruled that the amended complaint failed to allege facts that make it plausible "a prudent fiduciary in the same circumstances would not have viewed" pre-investigation disclosure by the HP Plan fiduciaries to be more likely to harm the Plan investment in HP stock than to help it. The court held that HP was entitled to investigate the Autonomy accounting irregularities. In fact, the court expressed its belief that that HP "would have been subject to claims of imprudence had it disclosed uninvestigated allegations." The court noted

that the consequences of freezing Plan investments in the HP stock fund "likely would have been dire," and a prudent manager could not have been faulted for waiting "to investigate the existence and extent of a third-party fraud before disclosing it to the market." *In re HP ERISA Litigation*, N.D. Cal., 2015