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EMPLOYEE BENEFITS DEVELOPMENTS JUNE 2016

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RULINGS, ETC.

EEOC Issues Final Wellness Program Rules. The Equal Employment Opportunity Commission (EEOC) issued final regulations describing how the Americans with Disabilities Act (ADA) and the Genetic Information Nondiscrimination Act (GINA) apply to employer wellness programs. These rules will become effective for employer-sponsored wellness programs as of the first day of the first plan year that begins on or after January 1, 2017. These two rules are intended to provide guidance for employers offering wellness programs that will be compliant with the ADA and GINA in a manner consistent with the Health Insurance Portability and Accountability Act (HIPAA) and the Affordable Care Act (ACA). Although many hoped these final regulations would harmonize these various rules, several inconsistencies remain and as a result the compliance landscape is even more complicated. Many employers encourage employees to improve their health through wellness programs designed to encourage healthier lifestyles and preventing disease. One way wellness programs are designed to achieve these outcomes is by providing financial incentives to employees who satisfy certain health related criteria. HIPAA and the ACA permit wellness programs that are part of a group health plan to offer rewards for "health-contingent" wellness programs, so long as certain conditions are satisfied and the financial incentives do not exceed certain limits. HIPAA and the ACA do not impose incentive limits on "participatory" wellness programs, such as a program that only ask employees to complete a health risk assessment. Unlike HIPAA and the ACA, however, the ADA places incentive limits on any wellness program that asks employees disability-related questions or conducts medical examinations regardless of whether the program is "participatory" or "health-contingent." Similarly, GINA requires incentive limits for any wellness program that asks questions about an employee's current or past health status regardless of whether the program would be considered only "participatory" under HIPAA or the ACA. Under both the ADA and GINA, a wellness program may provide a financial incentive up to 30 percent of the total cost of self-only coverage. In contrast, the ACA permits a financial incentive up to 30 percent of the cost of coverage the employee is enrolled in. Also, under the ACA employers may offer an incentive up to 50 percent of the cost of coverage for tobacco cessation programs. However, under

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the ADA rules, where an employer requires a health screening or other medical test for nicotine or tobacco, the incentive may not exceed 30 percent of self only coverage. Under this new guidance from the EEOC, employers must provide employees with detailed information about what medical information will be obtained through a wellness program, how it will be used, who will receive it, and restrictions on disclosure. In light of these new rules, employers sponsoring wellness programs should review their programs to confirm compliance.

Final Regulations Issued on Allocation Rules for Roth IRA Rollovers. The Internal Revenue Service (IRS) recently finalized a rule changing the allocation of pre-tax and after-tax amounts in connection with direct rollovers from designated Roth accounts. Under prior regulations, any amount paid in a direct rollover was treated as a separate distribution from any amount paid directly to the taxpayer, so that both pre-tax and after-tax amounts would be allocated to each distribution. Under the new rule, if disbursements are made from a designated Roth account both to the taxpayer and to the taxpayer's Roth IRA or another designated Roth account in a direct rollover, then pre-tax amounts will be allocated first to the direct rollover, rather than being allocated pro rata to each destination. This means that a plan participant may take payment of amounts that have already been taxed, while directly rolling over the earnings to a Roth IRA or another designated Roth account without incurring taxation on those funds.

The final regulations finalize proposed regulations that were issued in 2014, but delay the applicability date from January 1, 2015 to January 1, 2016. According to the IRS, the final rules are substantively the same as the proposed rules, but "express the rule differently to better reflect the ongoing rule and the transition rule." For distributions made between September 18, 2014 and January 1, 2016, the prior separate distribution rule applies, unless a taxpayer elects *not* to apply the rule for those distributions. The final regulations apply to distributions from designated Roth accounts made on or after January 1, 2016, and for such distributions, taxpayers are required to follow the allocation rules described in Notice 2014-54, which was issued in 2014. Under Notice 2014-54, a taxpayer may also direct pre-tax and after-tax amounts that are simultaneously disbursed to multiple destinations so as to allocate them to specific destinations. (Treas. Reg. § 1.402A-1, Q&A-5(a), as amended by T.D. 9769 (May 18, 2016)).

PBGC Increases Certain Penalty Amounts. The Pension Benefit Guaranty Corporation (PBGC) has amended its regulations to increase certain maximum penalties under two provisions of the Employee Retirement Income Security Act of 1974 (ERISA). Penalties under ERISA § 4071 (generally, for single employer plans the failure to notify the PBGC for reportable events, plan terminations, and failure to meet minimum funding standards) increased from $1,100 per day to $2,063 per day. Penalties under ERISA § 4302 (generally, for multiemployer plans the failure to notify the PBGC with respect to mergers and transfers in insolvent plans) increased from $110 per day to $275 per day. These penalty increases were required under provisions of the Federal Civil Penalties Inflation Adjustment Act Improvements Act of 2015 to reflect inflation adjustments from the time the penalties were first enacted. It should be noted that under the Regulations, a set penalty amount is no longer provided for in the Regulations, but will increase accordingly in the future for inflation. The increased maximum penalties apply beginning on August 1, 2016. (PBGC interim final rule 29 CFR Parts 4010, 4041, 4071, and 4302)

CASES

Second Circuit: Stock Drop Claims Barred by Statute of Limitations. Participants in Citigroup defined contribution plans filed a complaint in December 2011 to recover losses suffered in connection with plan investments in a Citigroup stock fund. The participants asserted ERISA breach of fiduciary duty claims based on the decline in Citigroup's stock price during the subprime mortgage crisis. A federal district court ruled that the participants' lawsuit is barred by ERISA's three-year statute of limitations, and the Court of Appeals for the Second Circuit agreed.

When a plaintiff has actual knowledge of an ERISA breach, the plaintiff must bring a claim within three years after the earliest date as of which the plaintiff acquired that actual knowledge. Because the participants in this case repeatedly alleged in their complaint that, prior to December 2008, there were widely publicized warnings about Citigroup's exposure to subprime mortgages, the Second Circuit agreed with the district court that the participants had the requisite knowledge necessary to invoke the three-year statute of limitations. The Second Circuit also agreed that any information that came to light after the three-year limitations period began to run was "redundant of the publicly available information and thus had no bearing on the calculation of the limitations period." Finally, in response to the participants' contention that they did not have actual knowledge of "a sustainable breach claim as a matter of law" until the Second Circuit issued its 2011 decision in *In re Citigroup ERISA Litig*., the court ruled that the participants "need not have knowledge of the relevant law" to have actual knowledge of a breach or violation for purposes to the ERISA three-year statute of limitations. *Muehlgay v. Citigroup Inc.* (2d Cir. 2016)

"Primary Purpose" of Stock Rights Plan Key to Decision that it was not covered by ERISA. The Ninth Circuit Court of Appeals recently held that the "paramount consideration" for determining whether a plan is a pension plan subject to ERISA, is "whether the primary purpose of the plan is to provide deferred compensation or other retirement benefits." The court issued this holding in conjunction with its ruling that an employer's Stock Rights Plan ("SRP") was not an ERISA-covered pension plan. Under the terms of the SRP at issue, the employer had "sole discretion" to determine at what time, in what amount, and to what employee to grant stock purchase rights. The employee-recipient then had to exercise the stock rights under a specified timeline. Once shares were acquired, the employee was expected to hold them until leaving the company, except that the employee could sell shares back to the company at any time.

In this case, a former executive participated in the plan prior to his retirement, and accrued 30,500 shares. He was encouraged to retire, and did so out of concern that he would otherwise be terminated. After he retired, the company—acting under terms of the plan allowing it to buy back the shares of terminated employees within 24 months—exercised its right to buy back his 30,500 shares for approximately $4.5 million. Just over one year later, the company sold a portion of the business and paid shareholders over five times the price per share it paid the former executive. Learning this, the former executive sued the company and individual defendants, bringing a variety of claims, including claims under ERISA.

In order to reach his ERISA claims, the court had to determine whether ERISA applied to the SRP. In doing so, the court examined the plan's stated purpose, which was "to provide incentives for Officers to continue to serve as employee of the Company and its subsidiaries," along with other company documentation indicating that the primary intent of the SRP was to provide for the company's long-term capital needs. Noting the amount of discretion granted to the Company when granting of stock rights under the plan, and also noting that the possibility that income can be deferred does not

automatically result in ERISA coverage, the Court ultimately ruled that the SRP was "not designed or intended to provide retirement or deferred income, [and was therefore,] not covered by ERISA." The court noted that its holding is in agreement with other Circuit Courts of Appeals, thus signaling a possible trend in the courts toward a primary purpose standard. This case underscores the importance of careful planning, designing, and drafting of benefit plans to ensure that company goals are met and unintended consequences are minimized. (*Rich v. Shrader*, 9th Cir. 2016)

Fired Executive Loses ERISA Retaliation Claim. The U.S. District Court for the Eastern District of Missouri recently halted a former company vice president's claim that she was fired in retaliation for complaining about possible violations of ERISA, concluding that she failed to present evidence to overcome her employers' legitimate reasons for firing her. The VP was a 17-year employee of the company who had worked her way up from answering the company's phones. She and the owner worked closely together to run the company. Over time, their relationship became strained, and the VP began sending disparaging emails about the owner to customers and other people. The owner eventually decided to hire a New York Life agent, who was the representative overseeing the company's 401(k) plan, to be the company's president. The president began serving before officially resigning from New York Life, and the VP, having made several calls to New York Life regarding the matter, complained to the company owner that the president's dual roles could create a conflict of interest and violate federal law and regulations. She never filed a formal complaint with New York Life or any government agencies, however.

Leading up to her termination, the VP continued sending disparaging emails outside the company regarding the owner and the new president. She also attended an industry conference with the owner and president, at which she refused to introduce the president to customers. Additionally, she would not cooperate with providing the president with certain company information he requested. Before she was fired, the owner and president gave her an opportunity to explain her actions but she did not adequately do so. After she was fired, she brought a lawsuit alleging wrongful termination and retaliation under ERISA. The Court ruled only on the ERISA claim, leaving the wrongful termination claim for a state court to consider.

ERISA specifically prohibits termination of an employee "because [s]he has given information or has testified or is about to testify in any inquiry or proceeding relating to [ERISA]." The Circuit Courts of Appeals are split as to whether informal, unsolicited complaints are covered by the statutory language. But rather than opine as to whether her complaint was covered by ERISA, the Court assumed it was, and found that she still could not make a case. The Court concluded that the former VP simply did not provide any evidence that would allow it to find that her termination was based on her plan-related complaints rather than the various reasons presented by her employer. While the ultimate future of protection for making informal, unsolicited complaints under ERISA is unclear in light of the Circuit split, it is important for employers to be aware that terminated employees may look to ERISA as a source for a claim against the employer if they can show they have made a plan-related complaint. (*Graham v. Hubbs Machine and Manuf., Inc.*, E.D. Mo. 2016).

ESOP Trustees Held Liable for Breach of Fiduciary Duty and Prohibited Transactions. The Supreme Court's decision in *Fifth Third Bank v. Dudenhoeffer* established the standards to be applied with respect to a retirement plan's ownership of publicly traded employer stock. For a discussion of *Dudenhoeffer*, please see our July 2014 newsletter. However, retirement plans owning or purchasing stock of closely held corporations were largely unaffected by the *Dudenhoeffer* decision. The recent Fifth Circuit decision in *Perez v. Bruister* serves as a reminder on the importance of process in the context of an

employee stock ownership plan ("ESOP") purchasing closely held employer stock from a business' owner.

Bruister and Associates, Inc. ("BAI") was in the business of installing and servicing satellite-television equipment. BAI established an ESOP. BAI's sole owner Herbert Bruister ("Bruister"), Amy Smith, and Jonda Henry served as the ESOP's trustees. Smith worked for BAI, while Henry acted as BAI's outside CPA. Over a three-year period, Bruister sold, directly and through a trust which Bruister and his wife controlled as 50% members, 100% of his BAI shares to the ESOP through a series of transactions for a mix of cash and notes. After the ESOP became the sole owner of BAI, BAI's business declined and the company went out of business. Alleging that the ESOP overpaid for BAI's stock, the Department of Labor ("DOL") and two ESOP participants sued Bruister, Smith, and Henry for, among other causes of action, breach of fiduciary duty and engaging in prohibited transactions.

The Issue of Liability

ERISA imposes a duty of loyalty on fiduciaries and also prohibits fiduciaries from causing a plan to engage in certain prohibited transactions. In general, a person may become a fiduciary by either being a named fiduciary under the plan document or as a result of the functions the person performs with respect to a plan, including exercising any authority or control over the management or disposition of plan assets.

Bruister contended that, since he recused himself from all trustee votes related to the transactions, he was not a fiduciary and, therefore, could not be held liable for any alleged breach of fiduciary duty or for having engaged in a prohibited transaction. The court rejected Bruister's contention, holding that Bruister had effectively exercised control over plan assets by (1) firing the first appraiser hired to value BAI's stock for being too thorough, (2) hiring a replacement appraiser to value BAI's stock, (3) influencing the outcome of the replacement appraiser's valuation, (4) making his opinion known to the other trustees, and (5) actively participating in all meetings related to the transactions. In addition, Bruister's attorney emailed the replacement appraiser (without copying the ESOP's counsel) indicating that the replacement appraiser needed to "tweak" his findings in order to get a higher price for Bruister after Bruister's attorney reviewed initial BAI valuations (that were not provided to the ESOP's counsel).

Having found Bruister to be a fiduciary, the court agreed with the district court that the trustees, in purchasing BAI stock on behalf of the ESOP, had breached their fiduciary duties. Among other things, Bruister (1) fired the ESOP's independent counsel, (2) caused his personal attorney to influence the replacement appraiser, (3) caused the replacement appraiser to send valuations to him before the valuations were sent to the other ESOP trustees, (4) caused the ESOP's counsel to be excluded from any communications relating to the valuation of BAI stock, (5) adjusted assumptions and figures used by the replacement valuator to obtain a higher valuation, and (6) generally did not speak up for the ESOP participants. Further, Henry and Smith admitted that they were concerned with Bruister's interests, notwithstanding their status as ESOP trustees.

ERISA prohibits a fiduciary from causing a plan to engage in transaction constituting a sale or exchange of property between a plan and a party in interest. An exemption to this prohibition applies if a transaction involves the purchase of employer stock for no more than adequate consideration. If the relevant employer stock has no generally recognized market, "adequate consideration" generally means the fair market value of the stock, as determined in good faith by the plan trustee (s). The court held that this exemption is an affirmative defense for which the plan trustees have the burden of proving and

that the trustees will carry their burden if they demonstrate they arrived at their determination of fair market value by way of a prudent investigation. Thus, even if a plan actually pays no more than fair market value for employer stock, a prohibited transaction may nonetheless result if the trustees did not conduct a prudent investigation in determining the stock's fair market value.

In the case at hand, the court held that the trustees were not entitled to rely on the replacement appraiser's valuations because the trustees (1) conducted an insufficient investigation into the replacement appraiser's background and qualifications, (2) overlooked communications in which the replacement appraiser and Bruister's personal attorney were working together to increase the valuation for the BAI stock, (3) failed to inform the replacement appraiser of significant information and risk factors that should have influenced the valuation, and (4) failed to carefully review the replacement appraiser's conclusions. As a result, the trustees failed to carry their burden to establish their entitlement to the benefit of the exemption from the prohibited transaction rule and, therefore, had caused the plan to enter into a prohibited transaction.

The Issue of Damages

The court upheld the district court's method for determining damages by subtracting the estimated fair market value of the BAI stock from the amount actually paid by the ESOP for the BAI stock. As noted above, a portion of the purchase price was paid in the form of a note from the ESOP, a significant portion of which remain unpaid. The trustees argued that it would be a windfall for the ESOP if it were awarded any damages until the ESOP had actually paid an amount equal to the court-determined fair market value for the stock. The court, joining other courts to consider the issue, rejected defendants' contention that damages should exclude unpaid debt or debt that is later forgiven.

Lessons on Process

The *Bruister* case provides several important lessons on the importance of process, including:

1. Even if a person recuses himself or herself from a vote (or is otherwise not entitled to vote) on a transaction involving a plan, if the person has taken actions to influence that vote, the person may still be considered a fiduciary with respect to the transaction being voted on.
2. A valuation report is not a talisman against ERISA liability. In particular, trustees should carefully investigate an appraiser's background and qualifications, ensure the expert is provided complete and accurate information necessary to complete the valuation, take steps to avoid even the appearance of any conflicts of interest, and carefully review the valuation report.
3. More generally, fiduciaries should document the steps taken to ensure that any fiduciary actions they take are the result of a prudent investigation.