EMPLOYEE BENEFITS DEVELOPMENTS FEBRUARY 2016

Hodgson Russ Newsletter
February 29, 2016

Rulings, Opinions, Etc

IRS Issues Guidance Regarding Application of ACA Fee to Expatriate Health Plans. Section 9010 of the Affordable Care Act (ACA) imposes an annual fee on covered entities engaged in the business of providing health insurance for United States health risks. The definition of covered entities for purposes of this fee is limited to health insurance issuers, health maintenance organizations, certain insurance companies, insurers providing Medicare Advantage, Medicare Part D, Medicaid, and multi-employer welfare benefit arrangements. Because it relates to United States health risks, expatriate coverage is generally not subject to this fee. The Internal Revenue Service (IRS) issued Notice 2016-14 providing guidance as to how to define expatriate health plans for purposes of applying this fee for 2016. The guidance defines expatriate policies as predominantly group health insurance policies that provide coverage to employees, substantially all of whom are: (1) working outside their country of citizenship; (2) working outside their country of citizenship and outside the employer's country of domicile; or (3) non-U.S. citizens working in their home country. Covered entities that satisfy this definition are generally exempt from this fee for 2016. However, the Treasury and IRS, in consultation with the Department of Labor and the Department of Health and Human Services, are developing proposed regulations that will address the definition of an expatriate health plan for future years.

New Normal Retirement Age Rules Proposed for Governmental Plans. Final regulations that generally pertain to the normal retirement age (NRA) requirements for qualified pension plans were issued in 2007, but the applicability of those regulations to governmental pension plans was delayed after comments and concerns were submitted to the IRS. In January, the IRS proposed regulations that provide new guidance and safe harbors under which a governmental pension plan may set the plan's NRA. Some of the key provisions in the proposed regulations are as follows:

- The proposed regulations would apply the reasonably representative requirement in the 2007 NRA regulations to governmental plans. Thus, a governmental pension plan's NRA must be an age that is not earlier than the earliest age that is

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reasonably representative of the typical retirement age for the industry in which the covered workforce is employed.

- A governmental plan would satisfy the safe harbor in the 2007 NRA regulations if the NRA under the plan is age 62 or if the NRA is the later of age 62 or another specified date, such as the fifth anniversary of plan participation.
- The proposed regulations generally would provide additional alternative safe harbors that would be deemed to satisfy the reasonably representative requirement:
  - An NRA that is the later of age 60 or the age at which the participant has been credited with at least 5 years of service.
  - An NRA that is the later of 55 or the age at which the participant has been credited with at least 10 years of service.
  - An NRA that is the participant's age if the sum of the participant's age plus the number of years of service that have been credited to the participant under the plan equals 80 or more.
  - An NRA that is a combination of any of the other safe harbors (except for the qualified public safety employee safe harbors) with 25 years of service, so that a participant's NRA would be the participant's age when the number of years of service that have been credited to the participant under the plan equals 25 if that age is earlier than what the participant's NRA would be under the other safe harbor(s).
- The proposed regulations also include three new or modified safe harbors specifically for qualified public safety employees.
- Use of one NRA for one classification of employees (such as qualified public safety employees) and one or more other NRAs for one or more different classifications of employees would not be inconsistent with these proposed regulations and generally would not be inconsistent with the applicable pre-ERISA requirements, including the requirement that any period of service required for full vesting at NRA be uniformly applicable.
- The proposed regulations would provide that in the case of an NRA under a governmental plan that fails to satisfy any of the governmental plan safe harbors, whether the NRA the reasonably representative requirement would be based on all of the relevant facts and circumstances. A good faith determination of the typical retirement age for the industry in which the covered workforce is employed that is made by the employer would be given deference, assuming that the determination is reasonable under the facts and circumstances and that the NRA is otherwise consistent with the pre-ERISA vesting requirements.

These regulations are proposed to be effective for employees hired during plan years beginning on or after the later of (1) January 1, 2017 or (2) the close of the first regular legislative session of the legislative body with the authority to amend the plan that begins on or after the date that is 3 months after the final regulations are published. Governmental plan sponsors, however, may rely on these proposed regulations for periods preceding the effective date, pending the issuance of final regulations. ([REG–147310–12; 81 Fed. Reg. 4, 599)

IRS Proposes Relief for Pension Plans Closed to New Participants. A significant number of employers have moved away from providing retirement benefits through traditional defined benefit pension plans. In some cases, employers have allowed employees who have already begun participation in a defined benefit pension plan to continue participating in that plan, while closing the plan to new participants. New employees typically participate in a defined contribution plan, such as a 401(k) plan.

Qualified retirement plans are required to comply with certain minimum coverage requirements under Section 410(b) of the Internal Revenue Code (the "Code") and nondiscrimination requirements under Code Section 401(a)(4). Closed plans must still satisfy the minimum coverage rules under Code Section 410(b) and the nondiscrimination rules under Code Section 401(a)(4). Many closed plans, however, encounter difficulty satisfying these requirements because the proportion of the grandfathered group of employees who are highly compensated employees compared to the employer's total workforce increases over time. In particular, grandfathered employees continue to receive pay raises that may cause them to become highly compensated employees, while newer employees are generally lower-paid non-highly compensated employees.

If a closed plan cannot satisfy the Code Section 410(b) minimum coverage test as a stand-alone plan, the closed plan may need to be aggregated with the employer's defined contribution plan. However, if the two plans are aggregated for purposes of Code Section 410(b) testing, then they must also be aggregated for purposes of Code Section 401(a)(4) nondiscrimination testing. In many cases, the aggregated plans may fail Code Section 401(a)(4) nondiscrimination testing unless they are permitted to demonstrate compliance with the nondiscrimination requirements on the basis of equivalent benefits.

As discussed in our April 2015 Employee Benefits Developments, the IRS has previously provided temporary nondiscrimination testing relief for certain employers with closed pension plans. In anticipation of the issuance of proposed regulations amending Code Section 401(a)(4), the temporary relief is set to expire at the end of the 2016 plan year. The IRS recently issued these proposed regulations that, if finalized, would make permanent changes to the nondiscrimination rules in order to help employers preserve the retirement expectations of grandfathered employees. Even though the regulations are not finalized, employers are generally permitted to rely on the proposed regulations for plan years beginning on or after January 1, 2014.

CASES

Supreme Court Refuses to Resolve Circuit Court Split on Definition of Normal Retirement Age. As previously reported, the U.S. Court of Appeals for the Second Circuit held that a defined benefit retirement plan could not define normal retirement age as completion of five years of service (see Employee Benefits Developments August 2015). The Second Circuit opinion found that, while there is no definition of normal retirement age under the Employee Retirement Income Security Act of 1974 (ERISA), the plan's language referencing a five-year period of service is inconsistent with the normal, usual, or typical meaning of "retirement," which more commonly means withdrawing from business or public life and living on one's income, savings, or pension. The Second Circuit found the plan's definition of five years of service would allow employers and employees to pick an unreasonably low age as normal retirement age. The Second Circuit refused to adopt contrary decisions in the Fourth and Seventh Circuit Courts of Appeals which held that normal retirement age could be defined by completion of a number of years of service. The U.S. Supreme Court has decided not to hear the appeal of the Second Circuit decision. The Supreme Court had previously refused to hear appeals of the decisions in the Fourth and Seventh Circuits. For now, there continues remain uncertainty on the definition of normal retirement age. (*PricewaterhouseCoopers LLP v. Laurent*, U.S., No. 15-638, cert. denied 2016).

Amgen v. Harris: The U.S. Supreme Court Rules Again on Pleading Standards for Stock Drop Cases. As it did in its 2014 decision in *Fifth Third Bancorp v. Dudenhoeffer*, the Supreme Court, in *Amgen Inc. v. Harris,* again considered whether the complaint of plan participants stated a sufficient claim against the plan fiduciaries for breach of the ERISA duty of prudence when the fiduciaries did not to remove the company stock fund from a 401(k) plan's investment fund line-up in the face of inside information regarding the stock's declining value. The Court of Appeals for the Ninth Circuit, with knowledge of the pleading standards prescribed by the Supreme Court in *Dudenhoeffer*, determined the complaint did state a sufficient claim for breach of ERISA fiduciary duties.

The Supreme Court, in a *per curiam* decision, disagreed and ruled that the Ninth Circuit failed to properly evaluate the complaint and incorrectly applied the *Dudenhoeffer* pleading standards. In *Dudenhoeffer*, the Supreme Court held that complaints involving breach of the duty of prudence on the basis of inside information "must 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."

In applying that standard to the *Amgen* case, the Ninth Circuit asserted that it is "quite plausible" the alternative action of removing the company stock fund from the plan's investment fund line-up would not have caused undue harm to the plan participants. The Supreme Court, however, could not find sufficient facts and allegations in support of that proposition in the complaint filed by the plan participants. Thus, the Supreme Court reversed the judgment of the Ninth Circuit and remanded the case to the District Court to determine whether the plaintiffs should be allowed to amend the complaint to more adequately state a claim for breach of the ERISA duty of prudence.

In its decision in *Dudenhoeffer*, the Supreme Court indicated that specific pleading standards must be met in order to state a valid claim in stock drop cases. The Court's recent decision in *Amgen* is a pointed reminder to plaintiffs and their counsel that meeting the pleading standards prescribed by the *Dudenhoeffer* decision must be met before a claim can be advanced. (*Amgen Inc. v. Harris*, US Sup. Ct. 2016)

Post-Tackett Retiree Health Care Decision Favors Employers. On February 8, 2016, a divided U.S. Court of Appeals, Sixth Circuit, in *Gallo v. Moen Inc.*, ruled that a group of retirees were not entitled to lifetime health care benefits under the terms of various collective bargaining agreements and a plant closure agreement because the agreements did not expressly state that the benefits were vested and unalterable for the life of the retires. The Sixth Circuit's decision was based on the Supreme Court's 2015 decision in *M&G Polymers USA LLC v. Tackett*. In Tackett, the Supreme Court held that ordinary principles of contract law determine the amount and duration of collectively bargained retiree medical benefits. Prior to *Tackett*, courts within the jurisdiction of the Sixth Circuit were able to conclude (under the so-call called Yard Man inference) that the parties to a collective bargaining agreement likely intended those benefits to continue for life where the agreement did not specifically address the duration of a retiree healthcare commitment. After *Tackett*, a court may not infer that the parties intended those benefits to vest for life when a collective bargaining agreement is silent as to the duration of retiree benefits.

The Facts. Between 1983 and 2005, Moen entered into a series of collective bargaining agreements most of which had 3 year general durational clauses. The agreements offered health benefits to individuals who retired from Moen's plant in Elyria, Ohio. Among other things, the 2005 collective bargaining agreement provided that "continued hospitalization, surgical and medical coverage *will be provided* without cost to past pensioners and their dependents . . . " (*emphasis added*). This agreement, which was the final agreement between the parties, terminated in 2008 when Moen shut down its Elyria operations. In connection with the plan shutdown, Moen and the union entered into a "Closure Effects Agreement" which provided that healthcare coverage "shall continue" for retirees and their spouses "as indicated under the [final] Collective Bargaining Agreement." Moen continued to provide the benefits for a time following the closing of the plant. In March 2013, Moen unilaterally decreased the benefits in response to improvements in Medicare, the emergence of more effective supplemental benefit plans, and the potential costs associated with the excise tax on high-value "Cadillac" healthcare plans. The union and several of the retirees sued Moen alleging that Moen could not change them because the benefits had vested under the terms of the collective bargaining and plant closure agreements.

The Majority Opinion. Guided by the Supreme Court's directives in *Tackett*, Circuit Judges Boggs and Sutton concluded that the collective bargaining agreements at issue did not provide unalterable healthcare benefits for life to the Elyria retirees and their dependents for the following reasons, among others:

- The collective bargaining agreements do not expressly state that Moen committed to provide unalterable healthcare benefits to retirees and their spouses for life.
- Each agreement contained a general durational clause that "supplied a concrete date of expiration after which either party could terminate the agreement." The court noted that when a specific provision of a collective bargaining agreement does not include an end date, the general durational clause determines the duration of the commitment. The fact that the collective bargaining agreement provided that continued coverage *will be provided* did not persuade the court that benefits were vested. The court reasoned the use of the future tense without more—without words committing to retain the benefit for life—does not guarantee lifetime benefits.
- The agreements explicitly vested pension benefits for qualifying retirees, but did not contain similar vesting language for the retiree healthcare benefits.

With respect to the impact of the plant closing agreement, the court held that most natural reading of that agreement is that it offers the same benefits under the same conditions as the 2005 collective bargaining agreement. Because a right to permanent healthcare benefits did not vest under that collective bargaining agreement, it did not vest under the plant closing agreement either.

The Dissenting Opinion. Judge Stranch disagreed with the majority, stating that the language of the collective bargaining and plant closure agreements—when properly viewed in their entirety—were ambiguous. He notes, correctly, that under ordinary principals of contract law, where agreements are ambiguous, extrinsic evidence may be used to resolve that ambiguity. The dissenting opinion cites to evidence in the record that supports the parties intent to vest retiree healthcare benefits. According to the dissenting opinion, the evidence includes statements from Moen representatives to retirees in negotiating sessions, before the pension committee, and in one-on-one conversations, that their benefits were "for life." The dissenting opinion notes that Moen's retiree enrollment forms do not warn that retiree health benefits could be cancelled or that a retiree's share of the premiums could be reduced. The dissent states that surviving spouses of retirees were assured in writing that "as long as" the spouse continues to receive a pension, they "would continue to be covered under the group insurance program." The dissenting opinion also notes that many employees, following the plant closing agreement but before plant closure, chose to take a significantly reduced pension and retire early under an active 2005 collective bargaining agreement in order to qualify for retiree healthcare benefits.

What This Case Means for Employers. The majority opinion is instructive for employers who may be thinking about altering or terminating existing retiree health care obligations. And while the dissent is not law, it should serve to inform employers who may be negotiating over new retiree health care commitments. Even the dissenting Judge in *Moen* would uphold the enforcement of a collective bargaining agreement that includes unambiguous language that retiree benefits are for the duration of the agreement only. As the dissent highlights, employer's should not assume that a general durational clause will mark the end of a retiree healthcare commitment where a specific end date for that benefit is not addressed within the four corners of the agreement. If a retiree benefit program is to have a limited duration, the agreement should say so in explicit terms. Employers should also be careful to ensure that summary plan descriptions, enrollment forms and other employee and retiree communications include "reservation of rights" clauses, and that benefits counselors who interact and communicate with retirees and their spouses receive proper guidance and training to ensure that their statements are accurate and complete with respect to the vesting of retiree benefits. Finally, to reduce the risk of a dispute about the intentions of the parties, employers should carefully document the circumstances surrounding contract negotiations. *Gallo v. Moen Inc.* (6th Cir. 2016)

Court Dismisses Executive's ERISA Claims Due to Prior Release of Rights. A Nebraska district court recently dismissed a former executive's ERISA claims because he signed a release waiving his ERISA rights with respect to his equity compensation at the time of his termination. Under an employment agreement signed in 2010, the executive received various stock-based awards under his employer's equity incentive plan. When the executive was terminated in 2011, the executive and his employer signed a mutual release in which they agreed that all outstanding equity awards granted to the executive were fully vested and exercisable. Under the terms of the release, the executive agreed to waive all claims and rights he may have under ERISA, reserving only his right to bring a claim for a violation of the release itself.

In 2015, the executive brought suit, claiming that his employer failed to comply with the terms of the equity incentive plan, a related award agreement, and the release by failing to convert all equity based compensation into immediately salable stock that he was to receive by October, 2011. In addition to a breach of contract claim, the executive alleged violations of ERISA and a state wage law. The employer moved to dismiss the ERISA claim, arguing that the equity awards, as administered under the equity plan and the award agreement, did not create an employee benefit plan subject to ERISA. The employer further argued that, even if an ERISA plan did exist, the signed release waived such claims and limited the executive's remedies to those for breach of contract. Declining to consider whether, prior to the signing of the release, the equity awards constituted or were distributed pursuant to an ERISA-governed benefit plan, the court focused instead on the release. Finding that the executive had waived all ERISA claims by agreeing to the release, the court rejected his argument that the release applied only to claims that had accrued up to the date of the release, and ruled that he could not accrue new ERISA claims subsequent to its signing. Accordingly, the court dismissed all of the executive's claims under ERISA. (*Manuel v. Aventine Renewable Energy Holdings, Inc.*, D. Neb. 2016)