FocusOn Call

BENEFITS LITIGATION UPDATE

A Publication from Epstein Becker Green and the ERISA Industry Committee

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401(k) Litigation Update

Tibble v. Edison International

U.S. Court of Appeals 9th Cir.

Kenneth J. Kelly, Member

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Lessons from *Tussey v. ABB, Inc.*

- Manage the plan as prudently as your personal investments, using leverage when possible
- Insure plan documents are compliant with developments in the law
- Identify and monitor responsible individuals
- Establish a senior-level oversight group
- Document all decision making

Key Facts in *Tibble* 401(k) plan:

- 20,000+ participants and $3.85 billion in assets
- Sponsor greatly expanded the "menu" after engaging a consultant, with union participation
- 50+ varied investment options offered
- Revenue sharing disclosed
- "Edison" consisted of several related entities
- Class action brought up major issues in 401(k) cases

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Issue No. 1: How far back can the plaintiffs' claims for imprudent plan design reach?

- Indefinitely (or as long as the current "imprudent" structure has been in place)?
- Time to sue expires three years after participants learn of fiduciary's breach?

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Answer: A claim for imprudent plan design can be brought for six years after the challenged investment option is included in the plan.

Lesson: Six years is a long time – document the decision making process in a formal "business record" that can be used as evidence at a trial.

Issue No. 2: Does the "safe harbor" of Section 404(c) provide a defense to claims of imprudent selection of investment options?

Section 404 (c) provides

In the case of a pension plan which . . . permits a participant . . . to exercise control over the assets in his account . . . -

No person who is otherwise a fiduciary shall be liable under this part for any loss, or by reason of any breach, which results from such participant's or beneficiary's exercise of control . . . .

Answer: No. Although Section 404(c) literally would apply, the selection of particular funds is a responsibility of the plan's fiduciaries, which precedes and is separate from the participant's decision to invest in a particular option.

Lesson: Don't count on Section 404(c) except where the investment option was prudently selected.

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<u>Issue No. 3</u>: Should the court accept the Edison Benefits Committee's interpretation of the following plan provision, which the Committee had decided allowed plan assets to be used to reduce Edison's costs of administration of the plan (*i.e.*, revenue sharing)?

> "The cost of administration of the Plan, *net of any adjustments by service providers,* will be paid by the Company [Southern California Edison Company]."

The Committee had full discretion to construe and interpret the plan and decided that accepting the "adjustments" (i.e., credits to Southern California Edison's payments to the service provider) did not constitute self-dealing or breach of fiduciary duty.

Sub-issue 3A: Should the court give deference to the Committee's decision under the "*Firestone*" principle or should the court make its own independent ("*de novo*") interpretation?

- Second Circuit: *Firestone* applies only to benefits determinations
- Third and Sixth Circuits: *Firestone* applies even where the issue implicates fiduciary duty breaches and conflicts of interest.

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<u>Answer to 3A (in the Ninth Circuit)</u>: A fiduciary's decision per a plan's broad grant of discretion to interpret and apply provisions, extends beyond benefits determinations unless the interpretation nullifies or evades an express ERISA prohibition.

<u>Lesson</u>: Wherever the plan is, the fiduciary should be given as broad a grant of discretion as possible; *Tibble* shows that interpretations may apply to many aspects of plan administration.

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Answer to Issue No. 3:

“Costs of administration” can reasonably mean either (a) gross costs associated with the service provider’s services (before the credit/offset) or (b) invoiced costs net of revenue sharing offsets. The court therefore accepted the latter as a reasonable “commonsense” interpretation of the provision, not an abuse of discretion, and not a “prohibited transaction” in violation of ERISA Section 406(b)(3).

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Factors influencing the court:

- Different entities benefited from the "discount" than that which selected the funds.
- DOL Advisory Op. 97-19A states that revenue sharing is not "consideration."
- Union had participated in the selections and discussed revenue sharing "extensively."
- SPD disclosed the practice.

Lesson: This may not be the last word on this issue.

See Healthcare Strategies, Inc. v. ING

<u>Issue No. 4</u>: What is the scope of ERISA Section 404(a)(1)(B), which provides:

> [A] fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and . . . (B) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with the aims . . . .

- Are all “retail” funds too costly and therefore imprudent by definition?
- Is the lowest expense ratio fund always the best choice?
- Does a “good” investment option end the inquiry?

Answer:

- The "process" by which decisions are made whether to include particular investment options in 401(k) plans is as important as the investment's results.

- If the fiduciaries thoroughly analyze the pros and cons of each potential investment option (and can prove it!), any non-irrational decision will most likely survive a lack-of-prudence challenge.

- STIF and "unitized" company stock fund decisions upheld despite imperfections.

Is life easier or harder after *Tibble*?

- Scrutinizing the "selection process" gives plaintiffs more opportunities for "granular" challenges (*e.g.*, the 3 retail classes or share class differences).
- Making the selection process an issue puts an additional burden on fiduciaries.
- Continued monitoring of the investment options is now a necessity; "What about TAA?"
- The fiduciary must ensure the consultant is qualified and that "reliance on the [consultant's] advice is reasonably justified under the circumstances."
- How can you remember what you considered six or more years later?

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Corollaries:

- More expensive (by expense ratio) “retail” funds are not necessarily imprudent since they have some benefits an investor may value.
- Engaging and relying on an experienced consultant is not a “safe harbor.”

Remember my question about *Tussey*?

"1. In view of the complexities and pitfalls of acting as a plan administrator and manager, as illustrated by the *Tussey* decision, why do it? Why not contract out as much of the administrative functions as possible?"

Postscript

- Plan recovered - $370,000
- Plaintiffs request - $407,277 counsel fees
- Defendants' computer techs - $530,000

The court's award is . . .?

<u>Answer</u>: Zero!

"Plaintiffs' tactic of submitting aggressive discovery requests and asserting numerous non-meritorious claims caused substantial costs for the Defendants. Awarding fees rewards such a shotgun approach."

-District Court opinion 8/22/11

The Last Term at the Supreme Court: *McCutchen*

John Houston Pope, Member

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Subrogation

- Plans commonly include term that obligates beneficiary to repay benefit costs when third-party source found liable for those costs
- Traditionally equitable remedy – do equitable defenses apply?

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Subrogation

US Airways, Inc. v. McCutchen (2013)

- Equitable defenses may not override express plan terms
- Ambiguous plan terms will be construed consistent with common law doctrines
    - Exposes plan to sharing costs of litigation

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Subrogation

McCutchen takeaways:

- Clean plan language
- Potentially increased role for plans in settlement tort lawsuits
    - Need for policies and procedures

The Next Term: *Heimeshoff*

John Houston Pope, Member

Upcoming Supreme Court Case

Heimeshoff v. Hartford Life

- Plan-imposed deadline to bring suit
- Measured from “proof of loss” – the date on which LTD benefits would have replaced salary
- 3 years from “proof of loss”

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Heimeshoff

- May a plan start its contractually based limitations period from a date before internal appeals are exhausted?
- Plaintiff and amici argue that administrators will cause delay in claim handling to bar lawsuits

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Heimeshoff

- Not challenging a plan's right to set reasonable period of limitation (in lieu of patchwork of state laws)
- Court will address whether a plan may start its contractually based limitations period from a date before internal appeals are fully exhausted
  - Plaintiff and amici argue that administrators will cause delay to avoid lawsuits.

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Heimeshoff

Workarounds abound:

- Shorter periods, measured from the end of internal appeals.
- Build an alternative into contractual limitations: e.g., 3 years or 90 days after internal appeals, whichever is later.

Obamacare Litigation Developments

John Houston Pope, Member

Obamacare Litigation Update

- Employer mandate upheld
  - Liberty University v. Lew (4th Cir. 2013)
- Origination clause challenge rejected
  - Sissel v. US Dep't HHS (D.D.C. 2013), on appeal

Obamacare Litigation Update

- Challenge to tax credits associated with federal exchanges to proceed
  – Pruitt v. Sebelius (E.D. Okla. 2013)
- New suit on same subject: Halbig v. Sebelius, Civ. No. 13-CV-623 (D.D.C.)
  – Aggressive plaintiffs immediately sought summary judgment in their favor
  – Government has moved to dismiss

Obamacare Litigation Update

Contraceptive Mandate

- New regulations to exempt religious non-profit institutions
- Courts divided over ability of for-profit corporations to contest mandate
- Supreme Court consideration likely
- Wider implications

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Brief Refresher Course:

The "*Moench* Presumption" in "Stock Drop" Cases

Kenneth J. Kelly, Member

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The ESOP fiduciary's dilemma when the employer's stock is dropping:

- Plan provides for investment in employer's stock
- Fiduciary duty requires "care, skill, prudence, and diligence" in the participants' interests
- ERISA does not require diversification with ESOPs

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The "Moench presumption": fiduciaries are presumed to have acted prudently in holding employer shares, but that presumption can be rebutted if and when the "investments no longer serve the purpose of the trust." Essentially, the ESOP presumption is a variant on the abuse of discretion principle.

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Factors considered:

- Plan language – requirement, encouragement or suggestion of investment in employer's stock?
- What was the sponsor's intent?
- Did the fiduciary know/suspect the employer in danger of collapse?
- Could reasonable fiduciaries have differed on a course of action?

U.S. v. Windsor – the DOMA decision

Where are we after Revenue Ruling 2013-17?

Joan A. Disler, Member

What the "DOMA Decision" Did

- June 26 – United States v. Windsor – the Supreme Court speaks
- Section 3 of DOMA which required that the federal government only recognize marriages of the opposite sex was struck down as unconstitutional
- Section 2 of DOMA which reserves the power to states to not follow other jurisdictions' rules on marriage was not addressed
- Over 1,000 federal laws and regulations effected, including those that apply to employee benefit plans

What the DOMA Decision Did Not Do

- Did not define marriage
- Did not provide specific guidance on recognizing same-sex marriages in states that do not permit them
- Did not indicate the effective date of the compliance with its holdings

Which State for Federal Law?

- Employer Decision point: determining a valid same-sex marriage for federal purposes (for plan benefits, tax benefits).
- Must a same-sex marriage in a state or district permitting such marriage ("State of Celebration") be recognized in a state that does not otherwise permit same-sex marriage (e.g., "State of Residence")?
- Particularly Burdensome on multi-state employer with, employees located in several states, only some of which recognize same-sex marriage
- Evident in ERIC poll (8/20 to 8/27)
  - In response to question: Will you consider same-sex spouses married if they live in a state that prohibits it?
  - 74% Responders undecided and/or awaiting guidance

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IRS Statement on the Supreme Court Decision on DOMA

"We are reviewing the important June 26 Supreme Court decision on the Defense of Marriage Act. We will be working with the Department of Treasury and Department of Justice, and we will **MOVE SWIFTLY** to provide revised guidance in the near future."

(Posted on 6/27/13 on IRS Website)(Emphasis Added)

Finally on Thursday August 29, 2013 at 2:15 pm

- E-mail from Gretchen Young containing a Press Release just posted on the Treasury's web site
- One day before the long Labor Day weekend
- Minutes after Doma article for EBG ERIC Update had been finalized

IRS NEWS RELEASE
August 29, 2013 at 2:15 pm

- "All Legal Same-Sex Marriages will be recognized For Federal Tax Purposes"
- Revenue Ruling 2013-17 and 2 sets of Frequently Asked Questions (FAQ's) are issued (don't arrive until 3:14 pm)

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Rev. Rule 2013-7 and FAQ's ("Ruling") - HIGHLIGHTS

- "SPOUSE" "HUSBAND" "WIFE" include SAME-SEX SPOUSES if the individuals are legally married under State law
- "STATE LAW" includes foreign jurisdiction
- Applies for Federal Tax purposes

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Rev. Rule 2013-7 and FAQ's ("Ruling") - HIGHLIGHTS

- And the Winner is . . . **State of Celebration** (15% Polled In ERIC POLL had this correct)
- IRS will recognize same-sex marriage entered into in a State that legally recognizes that marriage even if the state where the couple resides does not
- Ends uncertainty that caused by Windsor not addressing Section 2 of DOMA
- Not Surprising – same treatment IRS accords opposite-sex marriages

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Rev. Rule 2013-7 and FAQ's ("Ruling") - HIGHLIGHTS

- Persons in Domestic Partnerships and Civil Unions or other similar arrangements under State law will **NOT** be considered Married and will not get the same benefits as same-sex couples

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Rev. Rule 2013-7 and FAQ's ("Ruling") - HIGHLIGHTS

- The Ruling is effective **September 16, 2013**
- May be relied upon now to file amended returns for certain taxes already paid

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IMPACT on QUALIFIED RETIREMENT PLANS: SPOUSAL BENEFITS

Effective September 16, 2013, Same-sex spouse will be entitled to:

- Qualified Joint & Survivor Annuity (QJSA)
- Qualified Pre-Retirement Annuity (QPSA)
- Spousal Death benefit under 401(k) Plan
- Qualified Domestic Relation Order (QDRO)
- Required Minimum Distributions
- Hardship distributions based on needs of same-sex spouse

IMPACT on QUALIFIED RETIREMENT PLANS: SPOUSAL PROTECTIONS

Spousal consent must be extended to same-sex spouse on:

- **Beneficiary Designations**
- **Form of Payment**
- **Loans**

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IMPACT on QUALIFIED RETIREMENT PLANS: RETROACTIVE APPLICATION???

- Windsor declared a Federal law passed in 1996 “unconstitutional”
- Not clear how far back the decision should be applied
- Ex: 401(k) Plan paid a death benefit in Jan. 2013 in a lump sum to deceased participant’s sister designated beneficiary on form on file. Participant had a same-sex spouse to whom he was legally married (in NY).
  - Does Plan Sponsor owe the same-sex spouse the 401(k) Plan death benefit?
- In Rev. Rul. 2013-17 IRS said future guidance will be issued on prior periods
  - Plan amendment requirements and timing
  - Necessary corrections for administrative practice prior to September 16, 2013

IMPACT on HEALTH & WELFARE PLANS

- Employer payment of health premiums provided to same-sex spouse is not taxable for federal purposes
- Prior Tax Equalization Programs for legal same-sex spouses are not needed (but employer may want to keep for domestic partners/civil union partners)
- Pre-tax treatment for employee health premiums under a Cafeteria Plan must be given to same-sex spouse if offered to opposite-sex spouses

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IMPACT on HEALTH & WELFARE PLANS

- Same-sex spouse should be entitled to COBRA on same basis as opposite-sex spouses
- Legal marriages/divorces between same-sex spouses should be qualifying events to permit election changes under Cafeteria Plan
- Expenses of same-sex spouse should be eligible for reimbursement under FSA
- HIPAA'S special enrollment rights should apply to same-sex spouse

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FILING FOR REFUNDS

- Employee may file an amended return and recover taxes paid on the value of the health coverage of the employee's spouse provided by employer for "open years"
- Employee may file an amended return and recover taxes paid on an after-tax basis for premiums for health coverage for same-sex spouse for "open years" if employee was covered by employer's cafeteria plan at the time
- In situations above, employer may claim a refund for the Social Security taxes and Medicare taxes paid on such benefits for open years; streamlined procedure to be issued by IRS
- The above applies only for years where the statute of limitations is still open, which is generally the previous three years, e.g., 2010, 2011, and 2012
- Taxpayers who filed protective claims to hold open statute of limitations prior to 2010, may file for these years

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FILING FOR REFUNDS (cont'd)

- Employer may **not** claim a refund of over-withheld income tax for **prior years** (unlike employee who may do so for "open" years)
- Employer may make adjustments for over-withheld income taxes **in the current year** provided the employee is reimbursed by the end of the year

Other Agencies Guidance (to date) on determining a valid same-sex marriage

- Department of Labor issued an update to a Fact Sheet on 8/9/13 which advised that for FMLA will look to state of residence (**State of Residence**).
- Social Security Administration announced that effective 8/9/13 it will process claims of same-sex married individuals if they are residents of states recognizing the marriage at the time of application and hold all others (**State of Residence, currently**).
  - Possible effect upon defined benefit plans with off-set formulas and LTD plans which coordinate with social security benefits

Recent Court Cases

- *Obergefell v. Kasich* (DC SD Ohio, 7/22/13)– Same-sex husband wanted to be "surviving spouse" on death certificate. Held: Ohio must recognize same-sex marriage equally with other marriages solemnized out of state.
- *Cozen O'Connor, PC v. Tobits* (DC ED Pa, 7/29/13)– Where "spouse" was not specifically defined in Pennsylvania-based employer's plan, lack of consent by a same-sex spouse in Illinois invalidated a death-bed beneficiary designation to parents.

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NOW WHAT?

- Establish procedures to identify employees with same-sex spouses
- Stop imputing income for federal purposes on employer-paid health benefits if it is not done for opposite-sex spouses
- Continue imputing income for state purposes on employer-paid health benefits in those states which do not recognize same-sex marriage
- Determine whether to file refund claim for social security and medicare taxes paid for open years
- Develop “script” for a consistent approach to participant communication
- Review SPD, benefit election forms, including beneficiary designation forms, and employee communications to determine whether the definition of “spouse” will need to be revised in light of the *Windsor* decision and Rev. Rul. 2013-17.
- Continue to monitor IRS/DOL Guidance with respect to the specifics, particularly on retroactive application to qualified retirement plans

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This presentation has been provided for informational purposes only and is not intended and should not be construed to constitute legal advice. Please consult your attorneys in connection with any fact-specific situation under federal, state, and/or local laws that may impose additional obligations on you and your company.

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