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July 2006 Employee Benefits Update

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SELECT COMPLIANCE DEADLINES

Mandatory Electronic Filing of PBGC Premiums Began July 1, 2006

As of July 1, 2006, the Pension Benefit Guaranty Corporation ("PBGC") requires sponsors of large insured defined benefit plans (500 or more participants) to submit premium filings electronically. For a detailed description of these requirements, see the June 2006 Employee Benefits Update.

IRS User Fees Increased as of July 1, 2006

The Internal Revenue Service ("IRS") increased user fees related to employee plan determination, opinion and advisory letter requests as of July 1, 2006. The IRS also updated Form 8717 to reflect these increases.

Form 5500 Deadline for Calendar Year Plans is July 31, 2006

Plan administrators have seven months after the end of a plan year to file a Form 5500 Annual Report/Return. For plan years ending December 31, 2005, the deadline for filing the Form 5500 is July 31, 2006. Plan sponsors who extended their corporate federal income tax return may receive an automatic extension until September 15, 2006. Otherwise, plan administrators may apply for an extension until October 15, 2006 by filing a Form 5558 on or before July 31, 2006 (the plan's regular filing deadline).

PENSION PLAN DEVELOPMENTS

New PBGC Formula for Liability due to a Facility Shutdown For a Single Employer

On June 16, 2006 the PBGC issued a final rule amending the PBGC's regulations to create a new formula for determining liability for an underfunded single employer pension plan when an ERISA section 4062(e) event occurs. The new formula applies to any facility shutdowns occurring on or after July 17, 2006. The final rule is substantially similar to the proposed rule (issued by the PBGC in February 2005) with one clarification, which is described below.

ERISA section 4062(e) applies when more than 20 percent of a plan's active participants lose their jobs due to a facility shutdown. (In that event, section

4062(e) requires use of the rules related to the withdrawal of a substantial employer from a multiple employer plan, even though a single employer plan is involved.) Under the rules for multiple employer plans, a withdrawing employer is allocated liability based on the withdrawing employer's total of required contributions to the plan over the total of all required contributions to the plan. Accordingly, when there is an ERISA section 4062(e) event and these rules are applied to a single employer plan, the resulting calculation runs counter to the intended effect of the regulations. For example, these rules would result in an employer being liable for 100 percent of the plan's termination liability, even though only 25 percent of the active participants in the plan were separated from service as a result of the shutdown.

To resolve this inconsistency, the PGBC's new formula uses an approach that determines a plan's liability by multiplying a plan's full termination liability by a liability fraction which equals the percentage of the plan's active participants who were separated from service as a result of the cessation of operations. Specifically, the PBGC adopted the following formula:

The PBGC's final rule clarifies that the denominator of the liability fraction only

Amount of Liability Under § 4062(e)	=	Total Termination Liability	X	Number of active employee participants separated from service as a result of the cessation of operations
				Total number of employee participants before the cessation of operations

represents the number of active participants as of the date of cessation of operations. For example, if 500 employees are separated as a result of the cessation and the plan has 5,000 participants, but only 2,000 are active participants, the above liability fraction would be 25 percent (500/2,000), not 10 percent (500/5,000).

The PBGC did not issue any additional guidance on interpretive issues related to ERISA section 4062(e), did not create an exemption for small plans and did not place a cap on liability. Although commenters requested these changes to the

proposed rules, the PBGC explained that these topics were beyond the scope of the current rule. Lastly, the PBGC did not specifically address the time, form or manner of notice a plan must provide to the PBGC when a section 4062(e) event has occurred.

WELFARE AND FRINGE BENEFITS PLAN DEVELOPMENTS

IRS Provides Guidance on Leave Sharing Plans

On June 20, 2006, the IRS released Notice 2006-59, which describes the federal tax consequences of arrangements under which employees may deposit leave in an employer-sponsored leave bank for use by other employees who are adversely affected by a "major disaster," as declared by the President ("Major Disaster Leave Sharing Plans").

The Notice provides that the IRS will not treat donations of leave as income if the donations are made under a plan that meets the requirements of a Major Disaster Leave Sharing Plan.

A Major Disaster Leave Sharing Plan must be in writing and must treat payments to the leave recipient as wages for FICA, income tax withholding and other purposes. In addition, a Major Disaster Leave Sharing Plan must meet the specific requirements outlined in the Notice 2006-59. Key requirements include:

- Donated leave must be used for disaster-related purposes. However, the leave can offset a negative leave balance or be substituted for unpaid leave.
- The plan must adopt reasonable time limits on the deposit and the use of donated leave following a disaster.
- The employer must make a reasonable determination on how much donated leave should be provided to a leave recipient.
- The amount of leave that is donated in a year generally cannot exceed the employee's maximum leave accrual during that year.
- A donating employee may not specify a particular leave recipient to obtain his or her donation.
- Leave deposited in response to a specific disaster may only be used by employees affected by that disaster.

Plan Administrator's Claim Review Not Subject to Deferential Standard of Review

Where SPD, But not Plan, Grants Plan Administrator Discretionary Review In *Schwartz v. Prudential Insurance Company of America*, No. 05-2727 (7th Cir. June 13, 2006), the Seventh Circuit Court of Appeals found that Prudential's (the plan administrator) decision to deny long-term disability benefits to a plan participant was not entitled to a deferential arbitrary and capricious standard of review because the plan document did not grant Prudential discretionary review.

The plan document stated that, "[w]e may request that you send proof of continuing disability, satisfactory to Prudential, indicating that you are under the regular care of a doctor." The Seventh Circuit found that this language was not sufficient to grant Prudential discretion despite the fact that the plan's summary plan description ("SPD") contained language that gave Prudential discretion in granting benefits. The court noted that when conflicting language exists in a plan and an SPD, the language in the plan governs, unless a participant reasonably relied on the SPD language to his or her detriment. The participant in this situation did not detrimentally rely on the SPD language.

This case highlights the need for both the plan document and the SPD to contain sufficient, discretionary language for a court to grant an arbitrary and capricious standard of review of a plan administrator's decision.

Court Refuses to Impose Constructive Trust on Social Security Benefits

In *Mote v. Aetna Life Insurance Company*, 2006 WL 1744791 (N.D. Ill. June 26, 2006), a participant filed suit under ERISA seeking disability benefits. The defendant plan fiduciary counter-claimed, seeking a constructive trust on funds in the participant's possession from an overpayment of long-term disability benefits. The overpayment resulted from the participant's receipt of Social Security disability benefits. Relying on the United States Supreme Court's recent decision in *Sereboff v. Mid Atlantic Medical Services, Inc.*, 126 S. Ct. 1869 (2006), the plan fiduciary argued that this recovery was allowable.

The participant used case law precedent regarding Social Security funds to argue that the long-term disability overpayments were shielded from recovery because they were held in the same bank account as the Social Security funds, which were shielded from recovery under 42 U.S.C. § 407(a). Section 407(a) provides that Social Security funds are not transferable or assignable at law or in equity. The U.S. District Court for the Northern District of Illinois agreed with the participant

and dismissed the plan fiduciary's claim. The court concluded that "the funds on which the [plan fiduciary] seek[s] to impose an equitable lien are exactly the same funds that the law labels and treats as Social Security funds that are taken out of reach by Section 407(a)."

Trustees' Decision to Suspend Benefits to Recover Repayments Upheld

The U.S. District Court for the Southern District of Illinois ruled that the trustees of a collectively bargained health plan acted within their authority when they suspended benefits of a fund participant who failed to reimburse the plan after he received a third-party tort settlement. *Trustees of the Carpenters' Health and Welfare Trust Fund of St. Louis v. Brunkhorst*, No. 05-382-DRH (S.D. Ill. June 9, 2006).

The participant was involved in an altercation in which he received knife injuries. The plan paid approximately $40,000 for the participant's medical expenses. The participant signed an agreement with the plan that required him to reimburse the plan for the benefits paid on his behalf if he received a recovery from a third-party for the knife injuries. Subsequent to signing the reimbursement agreement, the participant received a $21,000 settlement. However, after he allocated parts of the settlement for other expenses, including his attorney's fees, the plan only received $6,283 from the participant's $21,000 settlement.

In response to the partial payment, the plan informed the participant that he was required to pay the entire $21,000 settlement to the plan pursuant to terms of the reimbursement agreement. The trustees began to withhold future benefits from the participant to recover the remaining $14,717. The participant filed a motion in state court for a temporary restraining order ("TRO") that would prohibit the plan from disrupting the participant's health benefits.

The district court found in favor of the plan, noting that ERISA barred the participant from obtaining a state TRO. The court also found that the reimbursement agreement "place[d] onto the participant responsibility for all attorney's fees, as well as all other claims against a settlement fund, by requiring that the amount of the participant's reimbursement obligation shall not be reduced on account of such items." Lastly, the court held that the trustees had the right to withhold future plan benefits from the participant until he paid the plan the remaining $14,717.

DEFERRED COMPENSATION DEVELOPMENTS

Final Code Section 409A Regulations Delayed Until Late Summer

The final Treasury Regulations interpreting Internal Revenue Code ("Code") section 409A were not completed by the Treasury's original June 30, 2006 release date. The Treasury Regulations are now expected sometime in late summer. A Treasury official surmised that the delay in publishing the final Treasury Regulations would create compliance and recordkeeping concerns and noted that officials are giving attention to determining an appropriate implementation schedule to aid plans in their efforts to comply with Code section 409A. The proposed compliance date for Code section 409A is January 1, 2007. Until final Treasury Regulations are issued, guidance under Notice 2005-1 is still applicable, and plans are required to be in compliance with Code section 409A, as modified by Notice 2005-1."