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July 2009 Employee Benefits Update

SELECT COMPLIANCE DEADLINES AND REMINDERS

Upcoming Medicare Part D Deadlines

Group health plans offering prescription drug coverage to Medicare-eligible employees (under either an active plan or retiree plan) must provide the ancornual creditable coverage disclosure to Medicare-eligible participants and dependents no later than November 14, 2009. Note: Effective January 1, 2009, the Centers for Medicare and Medicaid Services (CMS) updated its creditable coverage guidance and model disclosure notices (available at Creditable Coverage). Also, sponsors of group health plans must apply for the Medicare Part D retiree drug subsidy no later than 90 days prior to the beginning of the plan year, or October 2, 2009 for calendar year plans. A 30-day application extension is available if the extension request is filed by the application deadline. The subsidy application and extension should be submitted to CMS through the Retiree Drug Subsidy Center website at Retiree Drug Subsidy.

Expanded Mental Health Parity Act Is Effective for Plan Years Beginning After October 3, 2009

The Mental Health Parity and Addiction Equity Act of 2008 (MHPAEA) requires group health plans providing mental health or substance abuse benefits to provide such coverage at the same level as the coverage for medical or surgical benefits. More specifically, MHPAEA's expanded parity rules prohibit inequity in financial requirements (e.g., deductibles, copayments, coinsurance and out-of-pocket expenses), treatment limits (e.g., limits on frequency or number of visits) and out-of-network coverage. MHPAEA is generally effective for plan years beginning after October 3, 2009 (January 1, 2010 for calendar year plans). A delayed effective date may apply to collectively bargained plans. Before the compliance deadline, group health plan sponsors will need to carefully review coverage of mental health and substance abuse benefits and make any necessary design changes.

Michelle's Law Is Effective for Plan Years Beginning After October 8, 2009

Michelle's Law requires group health plans to continue health coverage for up to one year for college students who take a medically necessary leave of absence. Michelle's Law is effective for plan years beginning after October 8, 2009 (January

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1, 2010 for calendar year plans). Among other requirements, a group health plan must provide notice describing the terms of the health coverage extension required by Michelle's Law. This notice must be included as part of any notification regarding a requirement for certification of student status for health plan coverage. Plan documents and summary plan descriptions may need to be updated for Michelle's Law. In addition, health plan administrators will need to become familiar with the parameters of Michelle's Law's health coverage extension, including the requirement for a treating physician's written certification.

Updating Annual Open Enrollment Materials for Calendar Year Group Health Plans

The annual open enrollment period is approaching for many calendar year group health plans. Group health plan sponsors should review open enrollment materials to confirm that they have been updated for any design changes, as well as recent law changes, such as the two new 60-day special enrollment rights created by the Children's Health Insurance Program Reauthorization Act of 2009 and any changes required by MHPAEA (mentioned above). Also, as discussed below, CMS updated its Web site to include a form to help group health plan sponsors collect Medicare Health Insurance Claim Numbers (HICNs) or Social Security Numbers (SSNs) for those individuals for whom data must be reported. Group health plan sponsors should consider using the CMS form during the annual open enrollment process to collect the necessary information.

RETIREMENT PLAN DEVELOPMENTS

IRS Posts Compliance Guidance for Retirement Plan Sponsors and Administrators

The Internal Revenue Service (IRS) posted guidance on its website regarding plan audits that may be useful for retirement plan sponsors and administrators. The IRS posted an "Internal Controls Questionnaire" containing examples of questions asked by IRS examiners to gain an understanding of a retirement plan's procedures and internal controls. According to the IRS, this questionnaire is also intended to help plan sponsors and administrators understand the responsibilities and coordination needed to keep retirement plans in compliance with tax laws. The IRS also posted "Tips and Trends" to highlight issues routinely identified on audit and provide tips for avoiding common mistakes. Further, the IRS posted a "Taxpayer Documentation Guide" that contains a comprehensive list of documents needed during an IRS retirement plan audit. According to the IRS, this guide assists plan sponsors and administrators to identify the documents and information that should be available or recoverable and up-to-date when requested by an IRS examiner.

Joint Hearing on Target Date Retirement Funds

As noted in a Reinhart E-Alert from November 14, 2007, final Department of Labor (DOL) regulations designate target date retirement funds as a qualified default investment alternative (QDIA). Target date retirement funds are investment vehicles with a mix of equity and fixed income exposure that takes into account an individual's retirement date. More specifically, target date retirement funds automatically shift their asset allocation from riskier to more conservative investments as individuals approach retirement. This shift is also referred to as a fund's "glide path." Target date retirement funds have increased in popularity recently, due in large part to the DOL's final QDIA regulations. The DOL and Securities and Exchange Commission (SEC) recently held a joint hearing to review issues surrounding the use of target date retirement funds in 401(k) plans and by individual investors. According to the agencies, concerns have been raised about the variation in glide paths of target date retirement funds offered by different providers and how this variation may affect investors. The hearing focused on decisions regarding the funds' glide paths and underlying investments, information disclosed to plan sponsors, plan participants and individual investors and the use of the funds by investors. Based on the hearing's record, the agencies will determine whether regulatory or other guidance is needed to address concerns surrounding target date retirement funds.

Seventh Circuit Comments on Scope of ERISA Section 404(c) Protection

As summarized in Reinhart's March 2009 Employee Benefits Update, the Seventh Circuit Court of Appeals issued a decision earlier this year dismissing 401(k) plan participants' excessive fee claims. *Hecker v. Deere & Company*, 2009 WL 331285 (7th Cir. 2009). Under the facts of *Hecker*, 401(k) plan participants self-directed the investment of their accounts among a large number of investment vehicles offered under the 401(k) plan. In delivering its holding, the Seventh Circuit noted that ERISA section 404(c) protects a fiduciary that satisfies the criteria of ERISA section 404(c) and includes a sufficient range of investment options, even if it "does not always shield a fiduciary from an imprudent selection of funds under every circumstance that can be imagined."

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The Seventh Circuit recently denied a rehearing in the Hecker case with an addendum clarifying the earlier opinion's discussion on the scope of ERISA section 404(c) protection. The addendum responds to points raised by the DOL in its brief in support of rehearing and stresses that the earlier opinion's ERISA section 404(c) discussion was linked closely with the facts of the Hecker case. The Seventh Circuit states that the footnote in a preamble to final DOL regulations indicating that ERISA section 404(c) does not protect a fiduciary from liability resulting from an imprudent selection and monitoring of plan investment options is not entitled to full Chevron deference. The Seventh Circuit notes that it did defer to the DOL's concerns to the extent the court "refrained from making any definitive pronouncement on whether the safe harbor applies to the selection of investment options for a plan." Instead, the court states it left this issue open for future analysis under either a separate court case or DOL regulations directed to the issue. The Seventh Circuit also cautions that its earlier opinion does not suggest that a retirement plan fiduciary can insulate itself from liability simply by including a very large number of plan investment options and allowing participants to choose among the options.

Reinhart Comment: As detailed in Reinhart's May 2009 Employee Benefits Update, a New Hampshire district court recently held that ERISA section 404(c) protection is a defense unavailable to plan fiduciaries who are sued based on their selection of investment options available to plan participants. In re Tyco Inter'l Ltd. Multidistrict Litig., 2009 WL 921147 (D.N.H. 2009). In delivering its holding, the New Hampshire district court rejected the analysis applied by the Fifth Circuit in a similar case, Langbecker v. Elec. Data Sys. Corp. 476 F.3d 299 (5th Cir. 2007). In the Fifth Circuit case, the court held that the DOL's interpretation of ERISA section 404(c)'s scope was unreasonable, and that fiduciaries may use ERISA section 404(c) as a defense to claims based on a fiduciary's selection of investment options. However, given the DOL's position, plan fiduciaries should be prepared to justify their investment selection/monitoring decisions without relying on an ERISA section 404(c) defense.

HEALTH AND WELFARE PLAN DEVELOPMENTS

Additional COBRA Subsidy Guidance

The American Recovery and Reinvestment Act of 2009 (ARRA) creates a federal subsidy for COBRA premiums for certain employees and covered dependents who lose health plan coverage due to an involuntary termination of employment. Since ARRA's enactment, the DOL and IRS have issued numerous pieces of guidance on the new COBRA compliance requirements. The IRS recently updated its website to include more COBRA questions and answers (Q&As). To highlight some key points, the new Q&As address the following:

- Involuntary Terminations. If an employer determines that an employee's termination was involuntary for purposes of the COBRA premium subsidy and the employer's conclusion is consistent with a reasonable application of the law and IRS guidance, the IRS will not challenge whether the employer is entitled to claim a payroll tax credit for the COBRA premium subsidy provided to the employee. The employer must maintain supporting documentation of its determination of the employee's involuntary termination.
- Military Duty. An involuntary termination occurs if a member of a military Reserve unit or the National Guard is called to active duty, regardless of whether the employer treats the employee's absence as a termination of employment or a leave of absence.
- Effective Date of COBRA Coverage. An individual who is eligible for the extended COBRA election period must be offered COBRA coverage that is effective with the first period of coverage beginning on or after February 17, 2009. However, the employer or health plan may allow the individual to select a later effective date. In that case, for purposes of the nine-month limit on eligibility for the premium subsidy, the nine-month period would begin with the first period of coverage beginning on or after February 17, 2009. If an individual elects COBRA coverage to be effective as of a later date, the gap period (i.e., the period between the first period of coverage beginning on or after February 17, 2009 and the date COBRA coverage is effective) is not disregarded for purposes of applying the rules limiting preexisting condition exclusions.

In addition, if an individual requests eligibility for the COBRA premium subsidy and the claim is denied, the individual may request federal review of the denial. For individuals covered by group health plans of federal, state and local governments or group health plans subject to a COBRA-comparable state law, the federal review is provided by CMS. (For individuals covered by group health plans of private employers with at least 20 employees, the federal review is provided by the DOL.) CMS has updated its website at COBRA Continuation Coverage to provide information on the appeal process, including an application for individuals to use when requesting CMS review.

CMS Updates Mandatory Reporting User Guide & Provides Guidance on Collecting Participant Information The Medicare, Medicaid and SCHIP Extension Act of 2007 (MMSEA) added new mandatory reporting requirements for group health plans effective January 1, 2009. MMSEA requires insurers, third-party administrators and fiduciaries or administrators of self-insured health plans to gather information to help CMS determine when group health plans should pay primary to Medicare. CMS posts guidance on its website at Mandatory Insurer Reporting to implement these statutory reporting requirements. CMS recently updated its Web site to revise its user guide for group health plans. Among other changes, the user guide provides that group health plan responsible reporting entities (RREs) that will be reporting only health reimbursement account (HRA) data do not need to register with CMS at this time. HRA data will not be collected for reporting until after October 1, 2010. HRA-only RREs must register by May 1, 2010 to allow enough time for testing to be completed before production files are due.

Additionally, in response to reports from group health plans experiencing difficulty in obtaining either a HICN or SSN from certain participants, CMS updated its website to include guidance and model language for obtaining this information. According to CMS, if a group health plan chooses to use the model language and an individual refuses to provide a HICN or SSN, CMS will consider the RRE compliant for purposes of the next file submission if it: (1) obtains a signed copy of the model language in the format provided; (2) has the model language re-signed and dated at least once every 12 months; and (3) retains the documentation.

Sixth Circuit Rules ERISA Does Not Preempt Standard of Review Law

The Sixth Circuit Court of Appeals held that a Michigan law prohibiting insurers from including “discretionary clauses” in insurance contracts or policies was not preempted by ERISA because it fell within ERISA's “savings clause.” *American Council of Life Insurers v. Ross*, 558 F.3d 600 (6th Cir. 2009). A clause giving a fiduciary discretionary authority to interpret and apply the terms of an employee benefit plan is significant because it generally provides the fiduciary with a deferential standard of review if a benefit dispute is litigated. In this case, the Sixth Circuit noted that the Michigan law would be saved from ERISA preemption only if it regulated insurance. Applying a two-prong test from a prior U.S.

Supreme Court case, the court held that the Michigan law was both directed toward entities engaged in insurance and substantially affected the risk-pooling arrangement between the insurer and insured. Thus, the court held that the law regulated insurance and escaped ERISA preemption.

In delivering its holding, the Sixth Circuit noted that the U.S. Supreme Court's 2008 decision in *Metropolitan Life Insurance Co. v. Glenn* supported its conclusion that the Michigan insurance law is not preempted by ERISA. In Glenn, the Supreme Court held that where an insurer is responsible for both deciding eligibility for claims and making claims payment, the insurer acts under a conflict of interest that is a relevant factor in determining whether the employer abused its discretion. The Sixth Circuit stated that, based on the Glenn holding, it is difficult to understand why a State would be prohibited from eliminating the potential for a conflict of interest by restricting discretionary clauses.

Restaurant Association Asks U.S. Supreme Court to Review San Francisco's Fair Share Law

As explained in Reinhart's October 2008 Employee Benefits Update, the Ninth Circuit ruled that the City of San Francisco's fair share law is not preempted by ERISA. *Golden Gate Restaurant Ass'n v. City and County of San Francisco*, 2008 WL 4401387 (9th Cir. 2008). Among other requirements, the fair share law requires covered employers with 20 or more employees to either pay a fee to the City or make certain health care expenditures at rates based on the size of the employer. Payments to the City go towards funding a City-run health care program. (More information about the fair share law is available at Healthy San Francisco.) The Restaurant Association (and the DOL as amicus) argued that ERISA preempts the San Francisco ordinance either because it creates an ERISA "plan" or because it impermissibly "relates to" employers' ERISA plans. Opponents of the fair share law, including the DOL, maintain that if the law is upheld, it would potentially expose employers to a multitude of different state and local laws obligating the employers to design and administer their ERISA plans in accordance with such laws. The Ninth Circuit rejected these arguments and held that the ordinance escapes ERISA preemption because the City payment option allows employers to comply with the ordinance without creating or altering ERISA plans. The Restaurant Association has now petitioned the U.S. Supreme Court asking it to review whether ERISA preempts the fair share law.

OTHER DEVELOPMENTS

U.S. Supreme Court Increases Plaintiffs' Burden in Age Discrimination Cases

The U.S. Supreme Court increased plaintiffs' evidentiary burden in disparate treatment claims brought under the Age Discrimination in Employment Act (ADEA). *Gross v. FBL Financial Services, Inc.*, 2009 WL 1685684 (2009). The ADEA makes it unlawful for an employer to take adverse action against an employee because of the employee's age. Prior to the Supreme Court's Gross decision, courts routinely applied Title VII's burden-shifting analysis to ADEA cases where an employee alleged that he or she suffered an adverse employment action because of both permissible and impermissible considerations (i.e., a "mixed-motives" case). Under this burden-shifting analysis, if a plaintiff shows that discrimination was a "motivating" or "substantial" factor in the employer's action, the burden of persuasion shifts to the employer to show that it would have taken the same action regardless of that impermissible consideration. In Gross, the Supreme Court held that Title VII's burden-shifting framework does not apply to ADEA claims. The Supreme Court held that an ADEA plaintiff must prove by a preponderance of the evidence that age was the "but-for" cause of the challenged employer decision, and not merely a motivating or substantial factor. Further, the burden of persuasion does not shift to the employer to show that it would have taken the same action regardless of age.

IRS Guidance on Taxation of Business Cell Phones

The IRS issued Notice 2009-46 to request comments on three proposals designed to simplify the procedures for employers to substantiate employees' use of employer-provided cell phones and similar equipment. As background, under current tax law, if an employer provides and pays for an employee's cell phone, the employee receives a fringe benefit. To the extent the employee uses the cell phone for business purposes, the fair market value of such usage qualifies as a working condition fringe benefit excludable from the employee's gross income and the cell phone expense is a deductible business expense for the employer, if the substantiation requirements of Internal Revenue Code (Code) section 274(d) are satisfied. To the extent the employee uses the cell phone for personal use, the fair market value of such usage is includable in the employee's gross income. To simplify the substantiation requirements of Code section 274(d), Notice 2009-46 proposes the following alternative substantiation methods: (1) a minimal personal use method; (2) a safe harbor substantiation method; and (3) a statistical sampling method.

Reinhart Comment: After releasing Notice 2009-46, IRS Commissioner Douglas Schulman released a statement providing that the purpose of Notice 2009-46 is to simplify the rules for cell phone use and ease taxpayer burdens. According to Commissioner Schulman, the current tax law is burdensome, poorly understood by taxpayers and difficult for the IRS to administer consistently. Although some of the proposed changes would add clarity, Commissioner Schulman notes that the current law will inevitably lead to widespread confusion. Thus, Commissioner Schulman states that he and Treasury Secretary Tim Geithner ask Congress to pass legislation clarifying that there will be no tax consequences to employers or employees for personal use of cell phones and similar equipment.

Executive Compensation Developments

• *Impact of Treasury Department Acquisition on Code Section 409A*. Code section 409A prescribes requirements applicable to nonqualified deferred compensation plans. Final IRS regulations under Code section 409A set forth six permissible payment events for nonqualified deferred compensation plans, one of which is a change in the ownership or effective control of the corporation, or in the ownership of a substantial portion of the assets of the corporation. The IRS issued Notice 2009-49 to clarify that a transaction under the Emergency Economic Stabilization Act of 2008 (EESA) involving the acquisition by, or on behalf of, the Treasury Department of preferred stock, common stock, warrants to purchase common stock, or other types of equity of a financial institution or other entity is not a change in ownership or effective control, or a change in the ownership of a substantial portion of the assets of the corporation and, thus, is not a permissible Code section 409A payment event. Notice 2009-49 provides that the IRS intends to amend its regulations under Code Section 409A to reflect its guidance. Notice 2009-49 is effective for transactions occurring on or after June 4, 2009.

- *Interim Final Rules on TARP Compensation and Corporate Governance Standards*. The Treasury Department issued an interim final rule regarding the compensation and corporate governance standards that apply to entities receiving financial assistance under the Troubled Asset Relief Program (TARP). To briefly summarize, the interim final rule: (1) implements ARRA's executive compensation and corporate governance standards for TARP recipients; (2) includes additional executive compensation and corporate governance standards for TARP recipients under the statutory discretion given to the Treasury Department; and (3) establishes an Office of the Special Tax Master for TARP Executive Compensation. The interim final rule consolidates the executive compensation provisions directed at TARP recipients into a single rule. The standards under the interim final rule are effective as of June 15, 2009, except for ARRA amendments that were effective immediately upon enactment (e.g., the requirement for a nonbinding shareholder vote on executive compensation).
- *Treasury Secretary Outlines Compensation Principles*. In a June 10, 2009 press release, Treasury Secretary Geithner outlined the following five compensation

principles intended to align compensation practices with shareholders' interests and reinforce the stability of the financial system: (1) compensation plans should properly measure and award performance; (2) compensation should be structured to account for the time horizon of risks; (3) compensation practices should be aligned with sound risk management; (4) golden parachutes and supplemental retirement packages should be examined to determine if they align the interests of executives and shareholders; and (5) transparency and accountability should be promoted in the process of setting compensation. Moreover, Treasury Secretary Geithner stated that the Treasury Department will work with Congress to pass compensation legislation in two specific areas. First, the Treasury Department will support efforts to pass "say on pay" legislation (i.e., legislation giving the SEC authority to require companies to give shareholders a nonbinding vote on executive compensation packages). Second, the Treasury Department will propose legislation giving the SEC the power to ensure that all compensation committees are more independent, adhering to standards similar to those in place for audit committees under the Sarbanes-Oxley Act.