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newsletter

A report to clients and friends of the firm

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February 2015
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Editor's Overview

The Supreme Court cast a ray of sunlight for employers by rejecting the use of a problematic inference in adjudicating claims for retiree benefits brought pursuant to collective bargaining agreements. For many years, the Sixth Circuit has been applying the so-called "*Yard-Man*" inference, named after the decision in 1983 in which it was first crafted. Pursuant to this inference, a collective bargaining agreement with ambiguous terms regarding the duration of a promise of retiree welfare benefits is presumed to contractually "vest" the retirees in these benefits, such that the benefits cannot be removed after the expiration of the agreement. As explained in the article below, the Court unanimously held that the *Yard-Man* inference was inconsistent with the application of ordinary principles of contract law and that the inference improperly placed a thumb on the scale in favor of vested retiree rights.

As always please be sure to review the Rulings, Filings, and Settlements of Interest. This month features issues on same-sex marriage laws, in-plan roth rollovers and after-tax contributions, mass transit benefit limits, surcharge, and fiduciary status.

Supreme Court Dispenses With the *Yard-Man* Inferences[*]

By Amy Covert and Joe Clark

In a decision watched closely by both employers and unions, a unanimous Supreme Court has resolved a thirty-plus year split among the circuit courts on the standards governing claims for retiree health-care benefits arising from collective bargaining agreements. *M&G Polymers USA, LLC v. Tackett*, No. 13-1010, 2015 WL 303218 (U.S. Jan. 26, 2015). In *Tackett*, the Supreme Court rejected the longstanding Sixth Circuit inferences, known as the *Yard-Man* inferences, that parties to a collective bargaining agreement intend to vest retirees with lifetime health benefits in the absence of a specific contractual provision or extrinsic evidence to the contrary. In an opinion authored by Justice Clarence Thomas, the Supreme Court held that the inferences were inconsistent

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with ordinary contract principles, which should govern the interpretation of a collective bargaining agreement.

The Impact of *Yard-Man* and its Progeny

The *Yard-Man* inference developed over thirty years ago from the Sixth Circuit's 1983 ruling in *International Union, United Auto, Aerospace, & Agricultural Implement Workers of Am. v. Yard-Man, Inc.*, 716 F.2d 1476 (6th Cir. 1983), which was one of the earliest decisions to consider collectively-bargained retiree medical benefits. The facts of *Yard-Man* are common: The company told the union that it was shutting down a factory and would end the payment of retiree medical benefits on the last day of the collective bargaining agreement. The union sued, claiming that the retiree medical benefits were lifetime benefits that could not be terminated. The company responded that retiree benefits did not outlive the termination of the union contract. The key provisions of the contract stated that "[w]hen the former employee has obtained the age of 65 years then . . . [t]he [c]ompany will provide insurance benefits equal to the active group benefits . . . for the former employee and his spouse."

The Sixth Circuit found this language ambiguous as to whether it established a durational limitation on the availability of the benefits. To resolve this ambiguity, the court looked to other provisions of the agreement, including provisions for terminating both active employees' insurance benefits and a retiree's spouse and dependent benefits in certain circumstances. Because there was no corresponding termination provision specifically addressing retiree benefits, the court inferred an intent to vest lifetime retiree benefits. The *Yard-Man* court also reasoned that, if construed to terminate with the expiration of the agreement, the promise of retiree benefits would be "completely illusory for many early retirees" who would not reach retirement age before the contract expired. Lastly, the court relied on the "context" of labor negotiations to resolve the contract's ambiguity in favor of the union. The Sixth Circuit opined that "parties to collective bargaining would intend retiree benefits to vest for life because such benefits are 'not mandatory' or required to be included in collective bargaining agreements," and are "typically understood as a form of delayed compensation or reward for past services and are keyed to the acquisition of retirement status." The *Yard-Man* court accordingly characterized these benefits as "status" benefits, which carry with them an inference that they will continue so long as the prerequisite "status" is maintained. The *Yard-Man* court concluded that these contextual clues "outweigh[ed] any contrary implications derived from a routine duration clause."

In *Tackett,* the Supreme Court noted that the Sixth Circuit subsequently extended its reasoning in *Yard-Man* even further by holding that "absent specific durational language referring to retiree benefits themselves, a general durational clause says *nothing* about the vesting of retiree benefits," and a provision that "ties eligibility for retirement-health benefits to eligibility for a pension . . . [leaves] little room for debate that retirees' health benefits ves[t] upon retirement." The Supreme Court also noted that despite the Sixth Circuit's "repeated[] caution[s] that *Yard-Man* does not create a presumption of vesting, [it] ha[s] gone on to apply just such a presumption."

The Sixth Circuit's *Yard-Man* inferences conflict with the overwhelming majority of decisions in other circuits that hold that there is no right to lifetime benefits unless the language of the collective bargaining agreement manifests a clear intent that they be nonforfeitable. As a result, for employers operating in multiple jurisdictions, disputes over

the employers' right to alter the benefits of union retirees have often been less about the relative merits of the legal positions of the parties than about which circuit's precedents would control.

The *Tackett* Litigation

The plaintiffs in *Tackett* are retirees who had worked for Point Pleasant Polyester Plant in West Virginia. M&G Polymers USA, LLC purchased the plant in 2000, at which point M&G entered into a collective bargaining agreement and a Pension, Insurance, and Service Award Agreement (P & I Agreement) with the union. In relevant part, the P & I Agreement provided that M&G would pay all of the health costs for retirees who met certain criteria. The P & I Agreement provided for renegotiation of its terms in three years. There was no specific provision regarding the duration of the provisions governing retiree benefits.

In December 2006, M&G announced that it would begin requiring retirees to contribute to the cost of their health-care benefits. The retirees sued, arguing that the agreements created a "vested right" to lifetime health benefits for themselves and their families at no cost, which extended beyond the expiration of the agreement, and that the new requirement thus violated both the Labor Management Relations Act (LMRA) and the Employee Retirement Income Security Act (ERISA). The district court dismissed the case for failure to state a claim. Applying the *Yard-Man* inferences, the Sixth Circuit reversed, concluding that the retirees had stated a claim, and finding it "unlikely" that the union would agree to language that provides for a full company contribution if the company could unilaterally change the level of contribution. On remand, the district court conducted a bench trial and ruled in favor of the retirees. The district court declined to revisit the question of whether the P & I Agreement created a vested right to retiree benefits, finding that the Court of Appeals had definitively resolved that issue. The district court issued a permanent injunction requiring M&G to reinstate contribution-free health benefits. The Sixth Circuit affirmed, holding that although the district court erred in finding that the Court of Appeals' reversal conclusively resolved the meaning of the P & I Agreement, it had not erred in "presum[ing]" that "in the absence of extrinsic evidence to the contrary, the agreements indicated an intent to vest lifetime contribution-free benefits."

The Supreme Court Rejects the *Yard-Man* Inferences

The Supreme Court granted certiorari for the purpose of addressing, among other things, whether, when construing collective bargaining agreements in LMRA cases, courts should presume that silence concerning the duration of retiree health-care benefits means the parties intended those benefits to vest (and therefore continue indefinitely). In a unanimous opinion, the Supreme Court rejected the Sixth Circuit's use of the *Yard-Man* inferences, finding that they are "inconsistent with ordinary principles of contract law," insofar as they "plac[e] a thumb on the scale in favor of vested retiree benefits in all collective bargaining agreements."

The Court found that the Sixth Circuit's reasoning for applying the inferences was flawed in multiple respects. Among other things, it found that the Sixth Circuit had failed to apply two "traditional principles" that should govern the construction of ambiguous contracts: first, "courts should not construe ambiguous writings to create lifetime promises"; and second, "contractual obligations will cease, in the ordinary course, upon termination of the bargaining agreement." To that end, the Supreme Court held that "when a contract is

silent as to the duration of retiree benefits a court may not infer that the parties intended those benefits to vest for life."

Furthermore, while the Supreme Court conceded that courts "may look to known customs or usages in a particular industry to determine the meaning of a contract," as *Yard-Man* purported to do in construing the durational provisions of the collective bargaining agreement, it held that "the parties must prove those customs or usages using affirmative evidentiary support in a given case," and noted that the Sixth Circuit did not ground its *Yard-Man* inferences in any record evidence. The Supreme Court further rejected two of the premises on which the *Yard-Man* inferences were based, namely, the Court of Appeals' incorrect assertion that retiree health-care benefits are a form of deferred compensation and its supposition – incorrect in this case – that retiree health-care benefits are not subjects of mandatory collective bargaining.

The Supreme Court also took issue with the Sixth Circuit's refusal to apply a general durational clause to provisions governing retiree benefits, stating that this approach "distort[s] the text of the agreement and conflict[s] with the principle of contract law that the written agreement is presumed to encompass the whole agreement of the parties." Additionally, the Supreme Court noted that the Sixth Circuit misapplied the illusory promises doctrine, which instructs courts to avoid constructions of contracts that would render promises illusory, insofar as it construed provisions that benefited some class of retirees as "illusory" merely because they did not benefit all retirees. As the Court explained, "a promise that is 'partly' illusory is by definition not illusory."

Because application of the *Yard-Man* inferences affected the outcome in the rulings below, the Supreme Court vacated and remanded the case to the Sixth Circuit to review the agreements at issue under ordinary principles of contract law.

Justice Ginsburg filed a concurring opinion, joined by Justices Breyer, Sotomayor, and Kagan. In her concurrence, Justice Ginsburg agreed with Justice Thomas's emphasis on the rules of contract interpretation, but stated that these rules required consideration of all extrinsic evidence that could have a bearing on the construction of an ambiguous contract. She also identified contractual provisions that, she felt, could lead to a construction of the agreement so as to vest the retirees in their benefits.

View from Proskauer

Employers with unionized workforces in the Sixth Circuit can breathe a little easier knowing that when a court looks to extrinsic evidence to interpret ambiguous contracts, it will be without a thumb on the scale in either direction. The Supreme Court's opinion rejects the three rationales most commonly employed in support of claims for lifetime retiree health benefits – that the benefits are deferred compensation, that to prevent vesting the agreement must explicitly curtail the duration of the benefits, and that the duration of the health benefit is tied to the lifetime payment of pension benefits. This does not mean that employers will always prevail, but it should lessen the concerns by employers about litigating retiree benefit claims in the Sixth Circuit, as well as the inconsistency multi-jurisdictional employers faced by having different outcomes in different circuits.

Given the skyrocketing costs of healthcare, it is certain that, even post-*Tackett*, contractual vesting claims will continue to pose a substantial risk to employers seeking to cut back on retiree benefits. The risk is heightened by the fact that the Court did not provide clear guidance as to the role of extrinsic evidence in adjudicating these cases,

particularly given that four justices – but not a majority – opined that such evidence must always be considered. Therefore, as we have previously espoused, employers should do their best when negotiating collective bargaining agreements to draft contractual language that will clearly protect their rights to reduce or eliminate retiree welfare benefits.

Rulings, Filings, and Settlements of Interest

U.S. Supreme Court to Decide Fate of Same-Sex Marriage Laws

By Roberta Chevlowe and Stacy Barrow

> The U.S. Supreme Court will consider two important questions relating to same-sex marriage–whether states are required *to allow* same-sex marriages within their jurisdictions, and whether states are required *to recognize* same-sex marriages performed in other states. The decisions are expected to be issued in June of this year.

If the Court were to rule that states cannot prohibit same-sex marriage, there could be significant implications for some employee benefit plan sponsors. For example, sponsors of insured health plans in states that currently ban same-sex marriage may be required to provide health coverage to same-sex spouses. In addition, for sponsors of self-insured health plans that exclude same-sex spouses, there may be a heightened risk of liability under federal and state discrimination laws.

Stay tuned …

In-Plan Roth Rollovers and After-Tax Contributions: Maximizing Deferrals with Limited Future Tax Liability

By Lisa A. Berkowitz Herrnson and Damian A. Myers

> Plan sponsors seeking to provide employees with the ability to make after-tax contributions to a 401(k) plan may be interested in adding, along with the common Roth contribution feature, non-Roth after-tax contribution and "in-plan Roth rollover" features to their 401(k) plans. These additional features would allow plan participants to save up to $53,000 (for 2015 and as reduced by matching and other employer contributions) annually with limited future tax liability.

By way of background, 401(k) plans may permit two types of after-tax contribution options – Roth contributions and non-Roth after-tax contributions. Roth contributions are advantageous because although the contributions are made on an after-tax basis, neither the contributions themselves nor any earnings accrued on the contributions are taxable when distributed (subject to early withdrawal penalties). However, Roth contributions are limited by an annual deferral limitation of $18,000 (for 2015). Non-Roth after-tax contributions are similarly nontaxable at distribution, but any earnings accrued on the contributions are taxable at distribution. In 2010, the Small Business Jobs Act, as later amended by the American Taxpayer Relief Act of 2012, created "in-plan Roth rollovers," which allow participants to convert their non-Roth account balance (including pre-tax elective deferrals, matching contributions and after-tax contributions) such that Roth characterization applies thereafter (i.e., no tax on future earnings). Any taxable portion of the converted amount (such as pre-tax elective deferrals and matching contributions, or earnings attributable to non-Roth

after-tax contributions) will be subject to income tax in the year of conversion. An in-plan Roth rollover, however, will not trigger an early distribution penalty (provided the amount converted remains in the plan for at least five years).

If a plan design includes these three features, participants could maximize deferrals while limiting future tax exposure by following these three steps:

1. Elect to defer wages as Roth contributions up to the $18,000 (for 2015) annual deferral limitation.
2. Elect to defer wages in excess of the $18,000 (for 2015) annual limitation as non-Roth after-tax contributions up to the $53,000 (for 2015 and as reduced by matching and other employer contributions) annual limitation on contributions to defined contribution plans.
3. Convert the non-Roth after-tax contributions via an in-plan Roth rollover shortly after the contributions are made.

The conversion of the non-Roth after-tax contributions may result in some immediate tax liability if earnings have accrued since the date of contribution. However, after the in-plan Roth rollover, any future earnings will not be taxable at distribution.

Prior to adding these features to a 401(k) plan, plan sponsors should consider the following:

- Frequency of In-Plan Roth Rollovers. Allowing in-plan Roth rollovers on a frequent basis (for example, after each contribution date) would minimize participants' future tax liability because there would no taxable earnings on the conversion. However, frequent conversions could be administratively burdensome. Plan sponsors, therefore, may want to limit the number of in-plan Roth rollovers to one or two per year.
- ACP Testing. Non-Roth after-tax contributions are included for purposes of average contribution percentage (ACP) testing. Because those participants who are willing to contribute in excess of the $18,000 (for 2015) annual deferral limitation are more likely to fall within the "highly compensated employee" group, plan administrators should periodically check for ACP testing issues. To reduce the risk of an ACP test failures, plan sponsors could limit the annual amount of non-Roth after-tax contributions.
- Rollover Notices. IRS guidance related to in-plan Roth rollovers states that no rollover notice is required when the amount converted to Roth is not otherwise distributable (for example, pre-tax contributions or employer matching contributions). Because non-Roth after-tax contributions can be distributed at any time, it would appear that a rollover notice must be issued each time these contributions are converted in an in-plan Roth rollover.
- Participant Education. It is important for plan sponsors to ensure that participants obtain adequate guidance on the impact of non-Roth after-tax contributions and in-plan Roth rollovers. For example, by converting non-Roth after-tax contributions to Roth, the contributions are no longer freely distributable. Instead, once converted, the contributions may only be distributed without penalty upon permitted events (e.g., separation from service, age 59 ½, death, etc.). Additionally, if a participant also wishes to convert their pre-tax account balance

in an in-plan Roth rollover, he or she should be aware of the potential for significant tax liability in the year of conversion.

Deja-Vu All Over Again: Congress Once Again Retroactively Increases Mass Transit Benefit Limits

By Lisa A. Berkowitz Herrnson, Stacy Barrow and Emily Erstling

> Prior to the enactment of the Tax Increase Prevention Act of 2014 ("TIPA") in December 2014, effective for 2014, mass transit commuters were only able to contribute a maximum of $130 per month on a pre-tax basis toward their transit expenses (a reduction from $245 per month permitted in 2013). TIPA retroactively increased the maximum pre-tax contribution limit for employees' mass transit commuting expenses to the level permitted for parking expenses, i.e., $250 per month, as provided under Code Section 132(f). However, this increased monthly cap expired again on December 31, 2014, so it is currently capped at $130 for 2015, unless Congress extends it further. If this sounds familiar, it is. Congress took similar action to retroactively increase benefits in 2012, and the IRS issued similar guidance on retroactive adjustments in early 2013.

Because the TIPA increase in the monthly cap on pre-tax contributions for mass transit commuter benefits is retroactive to January 1, 2014, employees can potentially recoup some of the taxes withheld on amounts paid for commuting expenses over the previous monthly cap of $130. On January 2, 2015, the IRS issued Notice 2015-2 providing guidance to employers regarding adjustments for "excess transit benefits" paid over the previous $130 monthly cap up to the new 2014 $250 monthly cap. However, withheld Additional Medicare Tax (new under the Affordable Care Act) can only be repaid or reimbursed (and then adjusted) during the same calendar year in which it was withheld under applicable rules. Accordingly, any withheld Additional Medicare Tax and income tax are applied against the taxes shown on the employee's tax return, and the employee receives a refund from the IRS of any overpayment, unless the employer can use the special administrative procedure prescribed by the IRS in Notice 2015-2.

The special administrative procedure sets forth rules that an employer can follow to make adjustments if it has not yet filed its Form 941 for the fourth quarter of 2014, and repays employees any over-collected FICA tax (including the Additional Medicare Tax) on the excess transit benefits for all of 2014. If an employer has already filed its fourth quarter 2014 Form 941, it will have to follow the standard procedures for correcting the filing, including filing Form 941-X and obtaining a written statement from each affected employee that he or she has not, and will not, make a claim for a refund of FICA tax over-collected in the prior year, and may NOT repay any overpayment of Additional Medicare Tax. For more information on the special procedure and the standard procedure for adjustments, as well as making adjustments on employees' Forms W-2, see Notice 2015-2.

District Court Defines Surcharge Broadly

By Aaron Feuer

> A New York district court held that surcharge could include not only make-whole relief, but also consequential, exemplary, or punitive damages in limited circumstances where malice or fraud is involved. Plaintiff Janet D'Iorio alleged that Winebow breached its fiduciary duty by failing to provide an SPD and by making material misrepresentations about whether her commissions were included as income in determining LTD benefits. The court considered the extent of surcharge damages available to Plaintiff. Winebow argued that the surcharge remedy is limited to restitution, *i.e.*, the benefit payments D'Iorio would have received had her commissions been taken into account. The district court, however, was of the view that surcharge was not limited to make-whole relief, but was a remedy that was intended to provide all manner of compensatory damages. The court thus concluded that, under a surcharge theory, D'Iorio was entitled to pursue at trial consequential damages, exemplary, or punitive damages in limited circumstances where malice or fraud is involved. The court further noted that D'Iorio would have a difficult burden proving that she was entitled to punitive damages because there were no facts in the record suggesting that Winebow acted maliciously. The case is *D'Iorio v. Winebow, Inc.*, 2014 WL 7335466 (Dec. 26, 2014).

Service Provider Not A Fiduciary In Negotiating Its Contract

By Anthony Cacace

> A federal district court in Iowa dismissed a putative class action complaint brought by several 401(k) plan sponsors who alleged that Principal Life Insurance Company breached its fiduciary duties to the plans by charging excessive fees in connection with certain investment options and services provided to plan participants. The court determined, among other things, that Principal Life was not acting as a plan fiduciary because service providers do not act as fiduciaries when negotiating the terms of their service with the plans as long as the service providers do not control the named fiduciary's negotiation and approval of those terms. Here, there was no showing that Principal Life controlled the decision of the plan sponsors to hire it as a service provider to the plans. Furthermore, although Principal Life may have acted as a fiduciary in other respects (e.g., because it had discretion to select investment accounts and was an investment advisor), plaintiffs' excessive fee claims did not arise from actions taken by Principal Life in performance of those other functions. Thus, the alleged fiduciary status created by these other functions did not confer fiduciary status upon Principal Life with respect to the excessive fee claims. The case is *McCaffree Fin. Corp. v. Principal Life Ins. Co.*, 2014 WL 7060336 (S.D. Iowa Dec. 10, 2014).

Our ERISA Litigation practice is a significant component of Proskauer's Employee Benefits, Executive Compensation & ERISA Litigation Practice Center. Led by Howard Shapiro and Myron Rumeld, the ERISA Litigation practice defends complex and class action employee benefits litigation.

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