ERISA Newsletter

First Quarter 2018

A report to clients and friends of the firm
Edited by Stacey C.S. Cerrone and Russell L. Hirschhorn

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Editor's Overview

Despite the change in seasons, there appears to be no change in the pace of complex and class action ERISA litigation. Investments in defined contribution plans—both 401(k) and 403(b) plans—continue to be the leading target of the class action plaintiffs' bar, but these are hardly the only targets. As our colleague Ben Flaxenburg discusses in the article below, there are several opinions from circuit courts expected in the not too distant future and we anticipate that those decisions will offer useful guidance to plan sponsors and fiduciaries.

The balance of our Newsletter reviews a number of developments over the first quarter, including updates on the DOL fiduciary rule, the IRS impact on Health Savings Accounts, health care reform, retiree health plans, retirement benefits, top hat plans, standing and disability benefits.

View From Proskauer: Defined Contribution Plan Litigation Update – Appellate Decisions on the Horizon

By Benjamin Flaxenburg

The plaintiffs' bar for many years has filed lawsuits around the country against ERISA plan fiduciaries challenging the appropriateness of investment options in defined contribution plans, both with respect to the fees charged by such investments and their performance compared to other available investments. Over the past few years, there have been dozens of district court decisions addressing the sufficiency of—or lack thereof—those allegations.

This article focuses on three decisions, all of which are on appeal to their respective Circuits and are on track to be fully briefed in the coming months. The cases are *Brotherston v. Putnam Invs., LLC*, Case No. 17-1711 (1st Cir.); *Sweda v. Univ. of Pennsylvania*, Case No. 17-03244 (3d Cir.); and *White v. Chevron*, Case No. 17-16208 (9th Cir.). In *White* and *Sweda*, the plaintiffs attacked investment options that were not affiliated with the defendants; while, in *Brotherston*, the plaintiffs challenged affiliated investment options.

Non-Affiliated Fund Claims

Retail Share Class v. Institutional Share Class Claims

Plaintiffs often challenge the prudence of including in plan investment lineups retail share classes of mutual funds over less expensive institutional share classes. In both *White v. Chevron*, (N.D. Cal. May 31, 2017) and *Sweda v. Univ. of Pennsylvania*, (E.D. Pa. Sept. 21, 2017), the defendants persuaded the district courts to dismiss those claims.

In *White*, plaintiffs alleged in their complaint that participants lost more than $20 million through unnecessary investment fees associated with certain Vanguard funds (including some with fees as low as 5 bps) because there allegedly were identical Vanguard funds available with lower-cost share classes. The court explained that plaintiffs' complaint failed to create a plausible inference of disloyal conduct because it was devoid of any allegations of self-dealing or conflicts of interest. The court also determined that an imprudence claim could not stand merely by providing comparisons between funds in the plan and funds that were purportedly less expensive. In so ruling, the court explained that, even if it improperly shifted the burden to defendants to provide an explanation for their decisions, as plaintiffs desired, defendants had an "obvious" rationale for being in the retail-class shares, *i.e.*, the revenue sharing fees associated with these higher-cost share classes paid the plan's recordkeeping expenses.

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In *Sweda*, the court dismissed a similar claim, observing that nearly half of the plan investment options were in the institutional share class, and that there were reasons why a plan fiduciary would not, or could not, move the other investments into institutional share classes, such as high minimum investment requirements. The court explained that fiduciaries cannot discharge their duties with a "myopic focus on the singular goal of lower fees." Rather, ERISA requires a more nuanced balancing act, obligating fiduciaries to provide a diverse range of investment options while simultaneously defraying expenses where possible.

Underperformance Claims

Claims alleging that plan fiduciaries breached their duties by failing to remove underperforming investment options sometimes survive motions to dismiss when plaintiffs allege that the investment option had a history of underperformance. District courts, however, have become more skeptical of these claims, particularly when plaintiffs' allegations offer only a hindsight evaluation of an otherwise prudent decision. In *White*, for example, plaintiffs asserted that the fiduciaries breached their duties by offering and retaining a small-cap value fund that significantly underperformed its benchmark, peer funds, and comparable lower-cost investments. The court determined that plaintiffs' hindsight analysis was insufficient to state a claim. In *Sweda*, the court applied the same reasoning, even though just under half of the investment options outperformed their benchmark.

Stable Value Fund Claims

Plaintiffs have challenged a plan fiduciary's decision to include a money market fund, as opposed to a stable value fund, as a plan investment option because plaintiffs view stable value funds to be "safer" investments. The *White* plaintiffs argued that stable value funds outperformed money market funds during the putative class period, and that the decision to maintain a money market fund caused plan participants to lose over $130 million in retirement savings. Observing that ERISA does not have a per se rule requiring a 401(k) plan to offer a stable value fund as the plan's low-risk capital conservation option, the *White* court concluded that plaintiffs' attempt to infer an imprudent process from the inclusion of a money market fund instead of a stable value fund was implausible.

Administrative Fee and Revenue Sharing Agreement Claims

Plaintiffs have taken issue with revenue sharing agreements and arrangements with recordkeepers that they claim are not in the best interest of participants. In *White*, plaintiffs argued that the asset-based revenue sharing arrangement (in lieu of a fixed per-participant fee) was imprudent because, as the plan's assets increased, the fees paid to the plan's recordkeeper increased, even though there were no additional services provided. The court found plaintiffs' allegations were insufficient to state a claim because they did not allege the amount paid by the plan under the revenue sharing agreement and instead merely provided unsubstantiated estimates. The court also observed that ERISA imposes no obligation on fiduciaries to forecast future asset levels and proactively renegotiate asset-based fee arrangements.

The *White* plaintiffs also alleged that self-interest motivated Chevron to maintain the high-paying assets-based revenue sharing agreement with Vanguard, because Vanguard held a significant amount of Chevron shares in its mutual funds and allegedly had a practice of submitting proxy votes that favored Chevron's management. The court rejected that argument as well because plaintiffs failed to allege facts establishing that the plan fiduciaries were aware of Vanguard's voting practices or that Vanguard took a uniquely pro-management position with respect to Chevron.

The *Sweda* court rejected a similar claim, finding that it was within the plan fiduciary's discretion to determine a prudent arrangement. The court noted that in the asset-based model participants with higher account balances pay more, but under the flat per-participant model each participant pays the same amount regardless of account balance, meaning that participants with very small accounts pay as much as those with large accounts. Given that reality, the court stated that it would not infer it was imprudent for the fiduciary to choose an asset-based model.

Plaintiffs also alleged that the plan fiduciaries breached their duties by "locking" the plan into agreements with the plan's recordkeepers that required the plan to include certain investment options and by using two recordkeepers instead of one. The court found the locking-in claim implausible given that it is a common practice that allows parties to obtain better terms in exchange for agreeing to longer contractual periods. The court similarly determined that using multiple recordkeepers, each of whom had their own bundled investment options, was not imprudent, since it is common to bundle services to obtain the best possible terms from a recordkeeper.

Prohibited Transaction Claims

In addition to fiduciary breach claims, plaintiffs sometimes bring prohibited transaction claims, alleging that the plan provided a benefit to a party-in-interest. In general, fees paid to service providers are exempt from the party-in-interest prohibitions if the payments are found to be reasonable. In both *White* and *Sweda*, plaintiffs alleged that the plan paid excessive fees to recordkeepers, thereby precluding application of the prohibited transaction exemption for reasonable service provider fees. The *White* court dismissed the claim as time-barred under ERISA's six-year statute of limitations because the agreement between the plan and its recordkeeper dated back fourteen years before the complaint was filed. The *Sweda* court reached the merits of the claim and found that the mere act of paying a recordkeeper for its services, in the absence of additional allegations that the agreement would benefit plan fiduciaries at the expense of the plan participants and beneficiaries, could not establish a prohibited transaction.

Affiliated Fund Claims

In contrast to the claims discussed above, the plaintiffs' bar has been more successful in surviving a motion to dismiss where, as in *Brotherston v. Putnam Invs., LLC*, (D. Mass. June 19, 2017), they bring fiduciary breach claims challenging the inclusion of affiliated funds in a plan's investment lineup. In fact, some of the claims against Putnam Investments went to trial. But the claims ultimately were dismissed.

The plan participants alleged that defendants breached their fiduciary duties of loyalty and prudence and engaged in prohibited transactions by including affiliated mutual funds as investment options and by failing to offer the cheaper share class of those funds for a significant part of the putative class period. The court initially denied defendants' motion to dismiss, finding plausible plaintiffs' allegation that the plan fiduciary's decision to include affiliated funds was made to benefit the employer/investment company. The court subsequently denied defendants' motion for summary judgment on plaintiffs' fiduciary breach claims, finding that genuine issues of material fact precluded judgment on those claims. After a "case stated hearing," the court dismissed plaintiffs' prohibited transaction claims as time-barred or falling within an exemption to ERISA's prohibited transaction rules.

Following a bench trial, the court granted judgment for defendants on the remaining claims. It determined that, based on the totality of the circumstances, plaintiffs had failed to show that defendants' decision to include affiliated funds in the plan investment lineup amounted to a breach of loyalty where defendants also made substantial discretionary contributions to the plan (more than $40 million during the putative class period), provided additional services to plan participants, and paid for recordkeeping expenses. While the court declined to enter conclusive findings on whether defendants acted imprudently, the court determined that plaintiffs failed to establish a *prima facie* case of loss. In so ruling, the court rejected plaintiffs' theory that the entire investment lineup was imprudent because the plan relied on the expertise of Putnam's own investment division (and therefore lacked an independent monitoring process), finding that it was too sweeping and failed to pinpoint specific investment decisions that caused the participants to lose money. The court considered plaintiffs' theory an "unwarranted expansion of ERISA's seemingly narrow focus on actual losses to a plan resulting from specific incidents of fiduciary breach."

Proskauer's Perspective

The decisions in *White* and *Sweda*, on the one hand, and *Brotherston*, on the other hand, reflect the tendency at the district court level to distinguish viable from nonviable claims based on whether they include plausible allegations of self-dealing. It remains to be seen whether the appellate courts will draw the same distinctions. Regardless of the outcome of the forthcoming appeals, we anticipate that the appellate decisions will offer useful guidance to plan sponsors and fiduciaries.

Highlights from the Employee Benefits & Executive Compensation Blog

DOL Fiduciary Rule

Confusion Ensues After Appeal Over Fiduciary Rule in D.C. Circuit Dropped

By Seth Safra, Russell Hirschhorn and Steven A. Sutro

On March 23, 2018, the National Association for Fixed Annuities ("NAFA") and the Department of Labor filed a Joint Stipulation of Dismissal of litigation involving the Department's fiduciary rule in the District of Columbia Circuit. NAFA had appealed a district court decision that dismissed NAFA's challenge to the fiduciary rule. The decision to drop that appeal comes a little over a week after the Fifth Circuit vacated the fiduciary rule. As it stands now, the Fifth Circuit's decision vacating the fiduciary rule will remain the only appellate decision on the merits of the rule in its entirety. Although the Department announced that it will not enforce the rule, it has not withdrawn the rule and still has a right to request a rehearing on the Fifth Circuit's decision or it may petition the Supreme Court for certiorari. The case is *Nat'l Assoc. for Fixed Annuities v. Acosta*, D.C. Cir., No. 16-5345.

Fifth Circuit Vacates DOL Fiduciary Rule

By Seth Safra, Russell Hirschhorn and Steven A. Sutro

In a 2-1 decision, the U.S. Court of Appeals for the Fifth Circuit vacated the Department of Labor's fiduciary rule, including the expanded definition of "investment advice fiduciary" and the associated exemptions. The decision nullifies the Department's 2016 regulation—at least in the Fifth Circuit, which includes Texas, Louisiana, and Mississippi, and arguably nationwide—but is not likely to be the last word on this topic. The case is *U.S. Chamber of Commerce v. DOL*, No. 17-10238, 2018 WL 1325019 (5th Cir. Mar. 15, 2018). In response to the Fifth Circuit's decision, the Department announced that it will not enforce the fiduciary rule, pending further review. However, the Department did not withdraw the rule or speak for the IRS.

Over the course of more than forty pages, the majority decision recounted the history of ERISA's definition of fiduciary and concluded that the Department's expansion of the definition reflected a policy decision that was beyond the Department's authority. In so holding, the Court explained that expansion of service providers' obligations under the law and individuals' ability to enforce the law in court requires an act of Congress rather than an unelected agency of the Executive branch.

The Court first determined that the statute's definition of fiduciary was not ambiguous and must be interpreted consistently with the common law. In particular, the Court highlighted a distinction in

the common law between an "investment adviser," who regularly gives advice that is the primary basis for investment decisions, and a broker-dealer, whose principal role is sales. The Court concluded that the Department's 1975 definition of "investment advice fiduciary"—the five-part test that the Department said was outdated and too narrow—properly reflected that distinction. Although the Court left the door open for the Department to make changes to the definition, the Court rejected the Department's justification for a complete rewrite:

> That times have changed, the financial market has become more complex, and IRA accounts have assumed enormous importance are arguments for Congress to make adjustments in the law, or for other appropriate federal or state regulators to act within their authority.

Second, even assuming that the statute's definition of fiduciary was ambiguous, the majority concluded that the Department's expanded definition was not a "reasonable" interpretation of the statute. The Court detailed a number of reasons for this conclusion, including the following:

- The fiduciary rule ignores Congress's decision in ERISA to subject employer-sponsored plans to a different regime than IRAs. In particular, the Court observed that the statute does not subject IRA fiduciaries to ERISA's duties of prudence and loyalty or to ERISA's private right of action. The new Best Interest Contract Exemption would wipe away this distinction, because its conditions include a contractual commitment to the duties of prudence and loyalty that can be enforced by a private right of action.
- By the Department's own admission, the new definition of "investment advice fiduciary" could "sweep in some relationships that are not appropriately regarded as fiduciary in nature." The Court rejected the Best Interest Contract Exemption as a solution to this defect because the exemption is conditioned on taking on the very fiduciary status, responsibility, and risk that the Department acknowledged may not have been intended.
- The Best Interest Contract Exemption violates Constitutional separation of powers: only Congress may create privately enforceable rights of action. In addition, the exemption's restriction of arbitration provisions (subsequently abandoned by the Department) violates the Federal Arbitration Act.
- The fiduciary rule essentially outflanks Congressional initiatives under the Dodd-Frank Act to bestow oversight of broker/dealers upon the SEC. "Rather than infringing on SEC turf, DOL ought to have deferred to Congress's very specific Dodd-Frank delegations and conferred with and supported SEC practices to assist IRA and all other individual investors."

What does this all mean? The direct consequence of the Court's decision is that the expanded definition of "investment advice fiduciary" is no longer enforceable, at least within the Fifth Circuit. Pending review of the decision, the Department is not enforcing the fiduciary rule. We do not expect this to be the final word, however. The rule has not been withdrawn and the Department can still seek rehearing by the Fifth Circuit (either by the same panel or by the full Court) and/or review by the U.S. Supreme Court.

More indirectly, the decision articulates principles that could embolden the Trump administration's general deregulatory agenda and might affect the Department's review of the fiduciary rule. Even if other courts continue to disagree with the Fifth Circuit's conclusion (as the Tenth Circuit did most recently, discussed here), the decision further clears a path for withdrawing the fiduciary rule or a regulatory compromise that softens its impact—for example, by expanding the "seller's" exception and eliminating the most onerous requirements for the Best Interest Contract Exemption.

In the coming months and years, we expect to see continued focus on the fiduciary standard in all three branches of government:

- Challenges related to the Department's authority (both to create the new rule and to scale it back) are likely to continue in the courts.
- So far, the Department is continuing its review of the rule; and even if the Department puts it aside, a future administration could reopen the project.
- Members of Congress are likely to continue proposing legislation going both ways—with one side of the aisle seeking to expand the definition of fiduciary legislatively and the other side seeking consistency between DOL and the SEC.

It is too soon to guess where things will end up, and probably premature to change compliance strategies dramatically. Stay tuned.

Tenth Circuit Upholds DOL's Authority to Impose New Conditions for PTEs and Leaves Door Open for Changes to Fiduciary Rule

By Seth Safra, Russell Hirschhorn and Steven A. Sutro

The Tenth Circuit recently affirmed the Department of Labor's authority to impose new conditions for exemption from prohibited transaction rules with respect to the sale of annuity contracts. The case related to the Department's decision, as part of the 2016 "fiduciary rule," to make sales of fixed indexed annuities ineligible for Prohibited Transaction Exemption 84-24, requiring instead that sales of those products satisfy the more onerous requirements of the new Best Interest Contract Exemption ("BIC Exemption").

The plaintiff in the case, Market Synergy Group, alleged that the Department had not satisfied its obligation under the

Administrative Procedure Act to provide advance notice of "either the terms or substance of the proposed rule or a description of the subjects and issues involved." The Department's proposed rule would have affected only "variable annuity contracts and other annuity contracts that are securities under federal securities laws." Because they are not treated as securities under federal securities laws, fixed indexed annuities would not have been affected. But the Department requested comments on whether its proposal "[struck] the appropriate balance."

The Tenth Circuit held that the Department's request for comments on whether it had struck the appropriate balance was sufficient to satisfy the Department's notice obligations. In light of the request for comments, the court reasoned that extending the new requirements to fixed indexed annuities was a "logical outgrowth" of the initial proposal.

In addition to holding that the Department had satisfied its notice obligation, the Court also ruled that:

- It was not arbitrary to treat fixed indexed annuities like variable annuities (and less favorably than traditional fixed annuities), because the record established that the Department had sufficiently considered the products' complexity and risk, and potential conflicts of interest in the sales process; and
- The Department's regulatory impact analysis sufficiently addressed the effect that the more onerous BIC Exemption requirements would have on the insurance market before concluding that fears of increased costs were (1) overstated and (2) counteracted by the benefit to investors.

Meanwhile, the more onerous BIC Exemption requirements that were the subject of the litigation remain on hold until July 2019, pending the Department's review of the fiduciary rule. That review can still lead to a loosening of the conditions for the exemption, and possibly even a decision to put fixed indexed annuities back within the scope of PTE 84-24. The Court's decision leaves the Department leeway to make a final decision through the administrative process.

The case is *Mkt. Synergy Grp., Inc. v. United States Dep't of Labor*, No. 17-3038, 2018 WL 1279743 (10th Cir. Mar. 13, 2018).

IRS

IRS Reduces 2018 Health Savings Account Limit for Family Coverage

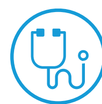
By Damian A. Myers

On March 5, 2018, the IRS released Revenue Procedure 2018-18, which, among other things, adjusts downward the 2018 total contribution limit to health savings accounts (HSAs) for individuals enrolled in family coverage. In late 2017, the IRS announced that the 2018 HSA limit for individuals enrolled in family coverage would be $6,900. The recently enacted tax reform legislation, however, required application of a new method of calculating inflation adjustments (*i.e.*, Chained Consumer Price Index for All Urban Consumers, or C-CPI-U) beginning in 2018. Using the C-CPI-U method, the IRS adjusted the HSA limit for individuals enrolled in family coverage downward to $6,850. The HSA limit for individuals enrolled in self-only coverage, and the deductible parameters for high deductible health plans did not change.

The downward adjustment of the HSA limit for individuals enrolled in family coverage presents administrative issues for employers and HSA administrators as many HSA enrollees may have already maxed out their family contributions. This is particularly challenging if an individual had contributed the IRS-approved $6,900 maximum amount and used all of the funds for permitted medical expenses only to find out, after the start of 2018, that the limit was lowered.

In the absence of transition relief (Rev. Proc. 2018-18 did not include any relief), it would seem that any contribution above the $6,850 limit would be treated as an "excess" contribution, even if the contribution is only equal to the $50 previously permitted by the IRS. Under current IRS guidance, taxpayers would have until the filing deadline for individual income tax returns (here, in most cases, April 15, 2019) to remove any excess contributions (and any earnings attributable to them). If the excess contribution (and earnings) is not timely distributed, it would be subject to a 6% excise tax (which would be triggered each year until removed from the HSA).

Although this downward adjustment of the 2018 HSA limit *after* the beginning of 2018 may be unwelcome news for individuals, employers, and HSA administrators, there is still time to take corrective action if necessary. It is possible that the IRS might re-consider the application of this lower limit to individuals who otherwise contributed in excess of the $6,850 limit (in reliance on earlier IRS guidance). Therefore, one approach might be to wait for a while and see if the IRS issues some form of transition relief. If not, taxpayers who contributed in excess of the $6,850 limit for family coverage should consider their options for correction.



Health Care Reform

Congress Delays the "Cadillac Tax" and Other ACA-Related Taxes and Fees

By Damian A. Myers and Cristopher Jones

On January 22, 2018 Congress passed (and the President signed) the Federal Register Printing Savings Act (the "Act"), which temporarily (until February 8, 2018) continued funding federal government activity and appropriates funds to various health-related programs (*e.g.*, the Children's Health Insurance

Program, Medicaid, and childhood obesity programs). In addition to providing for appropriations, the Act also addressed the following taxes and fees established under the Affordable Care Act ("ACA"):

> The effective date for the controversial 40% excise tax on high-cost health care (commonly referred to as the "Cadillac Tax") was delayed until 2022. The Cadillac Tax was originally scheduled to become effective in 2018, but in 2015 it was delayed (also in connection with budget legislation) until 2020. At a minimum, the new two-year delay gives employers and plan sponsors more time to adjust health plan design to avoid the Cadillac Tax. However, whether the Cadillac Tax ever becomes effective is certainly in doubt, as the tax is unpopular on both sides of the aisle.

> A new moratorium on assessment and collection of the fee imposed on health insurers under Section 9010 of the ACA will be applied to 2019. The fee, which was also subject to a moratorium in 2017, will still be assessed and collected for 2018.

> The moratorium on application of the 2.3% tax on medical device sales was extended through 2019. Absent future legislation extending the moratorium or repealing the tax, it will become effective on January 1, 2020.

The three taxes and fees described above were also targeted by the failed attempts at health care reform in 2017 (*i.e.*, the American Health Care Act and the Better Care Reconciliation Act). Those legislative attempts at health care reform also included delays or repeals of many other revenue-related provisions of the ACA. As noted above, the Act only funds the federal government until February 8, 2018, so additional budget legislation will be considered by Congress soon. It is possible that this future budget legislation will target other ACA-related provisions.

Retirement Plans

The Bipartisan Budget Act's Impact on Retirement Plans

By Paul M. Hamburger, Steven Einhorn and Randall Bunnell

On Friday, February 9, 2018, Congress passed, and the President signed, the Bipartisan Budget Act of 2018 (the "Budget Act"). The Budget Act contains a number of provisions that affect qualified retirement plans. Plan sponsors should consider the impact of the Budget Act on their retirement programs.

> ***Hardship Withdrawals***. The Budget Act relaxes the rules related to hardship withdrawals applicable to qualified defined contribution plans (and likely to 403(b) plans because the 403(b) regulations incorporate the 401(k) plans by reference), beginning with plan years commencing after December 31, 2018, in three significant ways:

- First, the Budget Act eliminates the requirement that a participant exhaust the opportunity to take loans under the plan before receiving a hardship withdrawal.
- Second, the Budget Act allows a participant to take a hardship withdrawal from the participant's elective deferral contributions, qualified nonelective contributions ("QNECs"), and qualified matching contributions ("QMACs"), as well as from earnings on each of those contribution sources. Prior to the Budget Act, a participant could take a hardship withdrawal from elective deferral contributions but not from QNECs or QMACs nor from earnings on any of those deferrals or contributions.
- Third, the Budget Act directs the Secretary of the Treasury to modify existing 401(k) regulations to the remove the rule prohibiting participants from making elective deferrals and other employee contributions to the plan from which the hardship withdrawal was taken and any other plans maintained by the employer (which includes other qualified retirement plans, 403(b) plans, and nonqualified deferred compensation plans) during the six-month period after taking a hardship withdrawal. The guidance likely will also address what happens to participants who otherwise might be in the middle of a six-month contribution suspension period once the new rule eliminating that suspension becomes effective. Finally, it is noteworthy to consider the potential impact of this new rule on nonqualified deferred compensation plans subject to Code Section 409A. Under the Section 409A regulations a nonqualified deferred compensation plan is allowed to cancel a participant's deferral election following a 401(k) hardship distribution (as well as an unforeseeable emergency distribution under the deferred compensation plan). Employers should consider whether they wish to continue the practice of cancelling deferred compensation plan deferrals after a 401(k) plan hardship distribution once the new 401(k) rule is in place.

> ***California Wildfire Relief***. The Budget Act contains special disaster-related rules for the use of retirement funds by an individual whose principal place of residence was in a Presidentially-declared California wildfire disaster area between October 8, 2017, and December 31, 2017, and who incurred an economic loss due to the wildfires (a "Qualified Individual"). This relief is similar to what was enacted last year for the victims of Hurricanes Harvey, Irma and Maria in 2017 as part of the Disaster Tax Relief and Airport and Airway Extension Act of 2017 (enacted on September 29, 2017) and also relief that was included in the Tax Cuts and Jobs Act for plan participants residing in Presidentially-

declared disaster areas in 2016 (enacted on December 22, 2017). Plans are not required to offer this special disaster relief. Plan sponsors who wish to offer this relief to participants impacted by the California wildfires may do so immediately, but their plan document must be amended to conform the terms of the plan to the plan's operation. The deadline for amending plans for this relief is the last day of the first plan year beginning on or after January 1, 2019 (*i.e.*, December 31, 2019 for a calendar year plan).

- A Qualified Individual can take a qualified wildfire distribution of up to $100,000. Qualified wildfire distributions are not subject to the 10% early withdrawal penalty, can be recontributed over a three-year period, and will be included in the participant's income ratably over three-years unless the participant elects otherwise.
- The Budget Act increases the loan amount that a Qualified Individual can take from his account under a qualified retirement plan to the lesser of $100,000 or the full amount of the individual's vested account balance. Qualified Individuals who have loans outstanding are permitted to delay loan repayments for up to one year.
- A participant who took a distribution after March 31, 2017, and before January 15, 2018, to purchase or construct a home in the area where the California wildfires occurred is permitted to repay such distribution if the participant was unable to actually purchase or construct the home due to the California wildfires. Such repayment must occur no later than June 30, 2018.

> ***Wrongful IRS Levy***. If an amount was withdrawn from an IRA or an employer-sponsored retirement plan due to an IRS levy that was later determined to be wrongful, the Budget Act permits the affected individual to recontribute the amount returned (including interest) as a result of the wrongful levy. This provision is effective with respect to "amounts paid" after December 31, 2017, but it is not entirely clear whether this relates to the date that the wrongfully levied amounts were paid from an IRA or plan or the date that the amounts were returned to the affected individual.

> ***Multiemployer Pension Plan Committee***. To assist in addressing the funding and solvency issues faced by many multiemployer pension plans and the Pension Benefit Guarantee Corporation, the Budget Act establishes the "Joint Select Committee on Solvency of Multiemployer Pension Plans." This committee is tasked with providing recommendations and legislative language by the end of November 2018 that will "significantly improve multiemployer pension plans and the Pension Benefit Guarantee Corporation." The bipartisan committee will be composed of 16 members, appointed by party leaders, with an equal number of members from the Senate and the House of Representatives. The co-chairs of the committee must be named by party leadership no later than February 23rd.

Retiree Health Benefits

Tackett Redux: Ordinary Principles of Contract Interpretation Mean No Inference of Vesting

By Seth Safra, Russell Hirschhorn and Benjamin Flaxenburg

In an opinion released yesterday, the Supreme Court reaffirmed that collective bargaining agreements (CBAs) must be interpreted according to "ordinary principles of contract law." *CNH Industrial N.V. v. Reese*, No. 17-515, 2018 WL 942419 (U.S. Feb. 20, 2018). In so ruling, the Court again rejected the Sixth Circuit's inference from silence that CBAs vested retiree benefits for life.

Three years ago, the Supreme Court decided *M&G Polymers USA, LLC v. Tackett*, 135 S. Ct. 926 (2015). In that decision, the Court unanimously held that CBAs must be interpreted according to ordinary principles of contract law, and the Court rejected the Sixth Circuit's so-called "*Yard-Man"* inference that if a CBA did not specify that retiree medical and other welfare benefits had a limited duration, the benefits were presumed to be vested. The Court 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.

The present dispute arose between retirees and their former employer about whether an expired CBA created a vested right to lifetime health care benefits. In 1998, the Company agreed in a CBA to provide health care benefits to certain "[e]mployees who retire under the . . . Pension Plan." Under the CBA, "[a]ll other coverages," such as life insurance, ceased upon retirement. The health care benefit was "made part of" the CBA and "r[an] concurrently" with it. The CBA contained a general durational clause stating that it would terminate in May 2004. The CBA also stated that it "dispose[d] of any and all bargaining issues, whether or not presented during negotiations."

After years of litigation, both before and after the *Tackett* decision, the Sixth Circuit concluded that the CBA's general durational clause did not apply to retiree health care benefits. In a split decision, the Sixth Circuit inferred from the CBA's specific termination provisions for "other coverages" that the parties must have intended to vest health care benefits for life.

The Supreme Court unanimously reversed the Sixth Circuit, holding that the Sixth Circuit's inference of vesting could not be squared with *Tackett* because it did not comply with *Tackett's* direction to apply ordinary contract principles. According to the Supreme Court, the CBA's general durational clause applies to all benefits, unless the CBA provides otherwise. Here, no provision specified that the health care benefits were subject to a different

durational clause. The only reasonable interpretation of the CBA was thus that the health care benefits expired when the CBA expired.

The Supreme Court's decision reaffirms that a court interpreting a CBA should not infer from silence that a retiree welfare benefit is vested for life. We expect that litigation over reductions to retiree medical benefits will continue (both for union employees and non-union employees), particularly in light of skyrocketing health care costs; but the Court's decision affirms that retirees will bear the burden of demonstrating an intent to vest based on affirmative documentary evidence.

Top Hat Plans

Third Circuit Deepens Circuit Split Over Test for "Top Hat" Status Under ERISA

By Neil Shah

A Third Circuit decision, *Sikora v. UPMC*, 876 F.3d 110 (3d Cir. 2017), deepens a circuit split over whether a participant's bargaining power is relevant to determining whether a plan qualifies for "top hat" status under ERISA.

Plans that qualify for "top hat" status are exempt from ERISA's eligibility, vesting, funding, and fiduciary requirements. To qualify, a plan must be unfunded and must limit coverage to a "select group of management or highly compensated employees." In *Sikora*, a former employee sued to recover a pension benefit that he forfeited upon termination of his employment on the ground that the forfeiture violated ERISA's vesting requirements. To make his case, he argued that the plan did not qualify for "top hat" statu —and therefore was not exempt from ERISA's vesting requirements—because the participants in the plan did not have bargaining power with respect to the plan. The Third Circuit held that bargaining power over plan design and operation is not relevant to determining whether a plan is limited to a "select group" of employees. Instead, the Court ruled that the inquiry should focus on the number of participants who are eligible (it should be a small portion of the employee population) and participants' compensation levels (to satisfy the "highly compensated" requirement).

In this case, the Third Circuit evaluated the demographics and found that the plan qualified as a "top hat" plan. As a result, ERISA's vesting requirements did not apply.

The Third Circuit's test aligns with the First Circuit. In contrast, the Second, Sixth, and Ninth Circuits have interpreted a Department of Labor Opinion Letter from 1990 to mean that courts should inquire as to a plan participant's bargaining power to determine whether s/he is a member of a "select group of management or highly compensated employees." The Third Circuit disagreed with that interpretation, stating that the Opinion Letter merely "observ[ed] that participants in top-hat plans were deemed by Congress to possess bargaining power 'by virtue of their position or compensation level.'" According to the Third Circuit, "engraft[ing] a bargaining power requirement onto the elements of a top-hat plan" would be contrary to the plain text of the statute and the Opinion Letter.

The *Sikora* decision serves as a fresh reminder that there is no single test for determining top hat status. The stakes are high: if an unfunded plan fails to qualify as "top hat," the sponsor can be forced to pay benefits far in excess of what was anticipated; the sponsor can become subject to funding and fiduciary obligations; and plan participants can be exposed to significant (and unexpected) adverse tax consequences. As such, it is worthwhile to review eligibility for unfunded plans and balance the desire to provide generous benefits against the risk of becoming subject to ERISA's eligibility, funding, vesting, and fiduciary rules.

Standing

Third Circuit Analyzes Standing for ERISA Plan Management Claims

By Lindsey Chopin

A recent Third Circuit decision reinforced the need for ERISA plaintiffs to plead injury-in-fact to establish Article III standing. In *Krauter v. Siemens Corp.*, No. 17-1662, 2018 WL 921542 (3d Cir. Feb. 16, 2018), the plaintiff was a beneficiary of four pension plans that had been sponsored by Siemens. After the Plaintiff's retirement, Siemens sold a division and transferred responsibility for Plaintiff's benefit obligations to the buyer. Plaintiff filed suit claiming that the transfer of his benefit obligation increased his risk of loss, although the Plaintiff never alleged that he was not paid the benefits he was owed. The Third Circuit held that the Plaintiff lacked standing: (i) to pursue claims based on his participation in the defined benefit plans because allegations of a risk of future adverse effects on benefits were not sufficient to confer Article III standing; and (ii) to pursue claims based on his participation in the deferred compensation plan because allegations that fees increased and investment options changed did not sufficiently allege actual harm. However, the Plaintiff did have standing to pursue a claim based on his participation in the 401(k) plan because he alleged that fees increased at the same time investment gains decreased, which, according to the Court, sufficiently alleged actual harm. Nonetheless, the Court affirmed dismissal of the claim because plaintiff failed to sufficiently plead facts to sustain his claims.

Disability Benefits

Plan Participant Waived Remedy for Untimely Benefits Determination

By Benjamin Flaxenburg

The Seventh Circuit rejected a disability plan participant's argument that an untimely decision denying his claim for long-term disability benefits warranted changing the standard of review from arbitrary and capricious to de novo. In so ruling, the Court explained that had plaintiff filed suit once the time for a timely decision had passed (because his claim was deemed exhausted under applicable regulations), rather than pursue an administrative appeal, the court would have considered an appropriate remedy, e.g., whether the claim should be reviewed de novo. By pursuing an administrative appeal, the Court concluded that the participant waived his right to a remedy for an untimely decision. The case is *Dragus v. Reliance Standard Life Ins. Co.*, No. 17-1752, 2018 WL 851164 (7th Cir. Feb. 14, 2018).

Withdrawal Liability

Seventh Circuit Rejects "Big Buyer" Defense to Successor Liability

By Anthony Cacace and Neil V. Shah

For a multiemployer pension fund to hold an asset purchaser liable for withdrawal liability as a successor-in-interest, the fund must establish that the purchaser was (i) on notice of the seller's withdrawal liability, and (ii) the purchaser "substantially continued" the seller's operations. In *Ind. Elec. Workers Pension Benefit Fund v. ManWeb Servs.*, No. 16-cv-2840, 2018 WL 1250471 (7th Cir. Mar. 12, 2018), the Seventh Circuit rejected the purchaser's so-called "big buyer" defense that it did not substantially continue the seller's business because the seller's operations made up only a small proportion of the purchaser's operations. In so ruling, the Court explained that the appropriate inquiry was the extent to which the purchaser continues the seller's business after the asset purchase, which required an evaluation of the totality of the circumstances. Here, the Court observed that the "big buyer" defense would allow a large buyer that continued its predecessor's business under a different name to escape liability simply because of its size, contrary to the goals of the Multiemployer Pension Plan Amendments Act of 1980 ("MPPAA") to protect multiemployer plans from the damaging consequences of employer withdrawals. In rejecting the "big buyer" defense, the Seventh Circuit distinguished as outdated an earlier decision by the Ninth Circuit in *Resilient Floor Covering Pension Tr. Fund Bd. of Trustees v. Michael's Floor Covering, Inc.*, 801 F.3d 1079, 1098 (9th Cir. 2015), which had held that the appropriate inquiry was whether a majority of the buyer's workforce consisted of the seller's former employees.

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