401(k) Fiduciary Suit, Top Hat Select Group, PPA Distributions, Supplemental Health, Fringe Benefits or Non-Employee Directors

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ERISA Litigation: 401(k) Plan Fiduciaries May Be Sued by Participants for Individual Losses

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The U.S. Supreme Court, in a unanimous decision in *Larue v. Dewolff, Boberg & Assoc. Inc.* issued on February 20, 2008, found that ERISA allows participants in 401(k) and other defined contribution plans to sue plan fiduciaries to recover for losses to their individual accounts when the losses result from breaches of duties, responsibilities, or obligations. This decision is significant in recognizing the existence of an individual right to sue for monetary relief under ERISA § 502(a)(2) and in distinguishing between defined contribution and defined benefit plans for ERISA purposes.

Under the Dewolff 401(k) plan, participants could choose how their plan contributions would be invested. Mr. Larue alleged that during 2001 and 2002, he made certain elections that DeWolff failed to carry out, which resulted in a $150,000 depletion of his interest in the plan. He sued, claiming that DeWolff had breached its fiduciary duty and seeking relief under ERISA §§ 409(a) and 502(a)(2) for the $150,000 value his account lost. ERISA § 409(a) makes fiduciaries liable for losses to the plan caused by breach of fiduciary duty and requires the lost profits to be restored to the plan. ERISA § 502(a)(2) allows a plan participant to sue to recover benefits, enforce rights under the plan, or clarify rights to future benefits.

In 1985, the Supreme Court had held that ERISA does not authorize a participant in a defined benefit ERISA disability plan to sue for individual damages caused by a delay in processing her claim when the fiduciary breach did not harm the plan itself. See *Massachusetts Mut. Life Ins. Co. v. Russell* , 473 U.S. 132 (1985). That decision was understood by many, including the Fourth Circuit in Larue, to foreclose a participant's ability to sue for individual damages under ERISA. In ruling that a fiduciary breach that injures the individual accounts that distinguish a defined contribution plan is actionable under ERISA § 502(a)(2), even if the breach does not threaten the solvency of the entire plan, the Court in Larue shows that participants can sue for monetary relief in certain circumstances.

Exec Comp: Deferred Compensation Plan with 15% Participation Is Not a Select Group Under a Top Hat Plan

Gary Quintiere & Veronica Rouse

Plan sponsors should carefully review the participants of any deferred compensation plan that is intended to serve as a "top hat" plan, as the Sixth Circuit is taking a stricter view of these plans. Generally, a "top hat" plan is characterized as one in which participants are able to direct or control negotiations with the employer regarding the design and operation of the deferred compensation plan such that the substantive rights and protections of ERISA are not necessary.

Earlier this year, a district court in the Sixth Circuit ruled that regardless of the fact that certain plan participants generated a threshold of gross commissions totaling $275,000 in order to be eligible for the plan, the plan was not a "top hat" plan because the percentage of the total workforce invited to join the plan was 30% even though the actual participation in the plan was around 15%. (*Daft v. Advest, Inc.,* No. 5:06 Civ. 1876 (N.D. Ohio January 18, 2008)). Although the court acknowledged there was no bright line test, it is obvious that percentages considered low in practice may not seem so in litigation.

Further, this case signals that the "select group" test used by the court may be more heavily considered than the "highly compensated" or "management" designations placed on most "top hat" participants. Although these employees made $275,000 or more in commissions, the court accused Advest of not providing enough information to convince the court that the plan participants' base compensation was not relatively low. The court rendered its ruling based on the possibility that these participants would not be considered highly compensated and probably not considered management. Ultimately, during the court's deliberations, the "bargaining power" element of a "top hat" plan took a back seat to the "select group" test requirements.

Including participants who do not have the ability to influence the design and operation of their deferred compensation plan may jeopardize the plan's characterization as a "top hat" plan. In a Sixth Circuit Court ruling last year that reversed a district court, the plan at issailed to withstand scrutiny under the four-prong "select group" test (Bakri v. Venture Mfg. Co., 473 F.3d 677 (6th Cir. 2007)). That test requires a deferred compensation plan to consider the following:

1. The percentage of the total workforce invited to join the plan;

2. The nature of the participants' employment duties;

3. The compensation disparity between the "top hat" plan members and nonmembers; and

4. The plan language.

Thus, the Sixth Circuit makes it clear: you cannot buoy base compensation with bonuses or commissions to create a top hat plan, and you must evaluate the percentage of the workforce eligible to join the plan -- not just the actual percentage of participants in the plan.

There are only a small number of decided "top hat" cases on record, but this may be a growing area of litigation. A lack of definitive guidance in this area as to how much workforce coverage is too much and which factors are the most important makes cases such as these even more noteworthy.

Qualified Plans: IRS Provides Guidance on Distribution-Related Provisions of Pension Protection Act

Fred Oliphant & Veronica Rouse

The IRS recently released Notice 2008-30, in which it addressed a number of distribution-related provisions of Pension Protection Act of 2006 (PPA 2006) that are effective in 2008. The following are a few of the highlights from the Notice:

Rules Governing Rollovers to Roth IRAs

PPA 2006 amended the definition of a qualified rollover contribution to a Roth IRA under Code Section 408A to include (i) rollovers from qualified plan distributions via a trustee-to-trustee transfer or a rollover within 60 days of distribution and (ii) rollovers from annuity plans and governmental plans, provided the participant meets certain income limitations. The Notice clarifies that qualified rollover contributions from an eligible retirement plan other than a Roth IRA are exempt from additional tax under Section 72(t) unless the amounts are distributed from the Roth IRA within five years. The Notice also clarifies that plans must permit a participant to elect a direct rollover to a Roth IRA unless the transaction qualifies for the exceptions for small amounts and multiple distributions under Treas. Reg. § 1.401(a)(31)-1. The Notice further provides that plan administrators do not need to certify the eligibility of the rollover to a Roth IRA and ineligible rollover amounts may be recharacterized pursuant to Section 408(A)(d)(6). The Notice also discusses the withholding requirements that apply to an eligible rollover distribution to a Roth IRA, and rollovers by non-spouse beneficiaries.

Complying with the New Qualified Optional Survivor Annuity Requirement

PPA 2006 amended Section 417 to require plans subject to Section 401(a)(11) to offer participants a specified optional form of benefit as an alternative to the Qualified Joint and Survivor Annuity (QJSA). The optional form of benefit is the Qualified Optional Survivor Annuity (QOSA), which is an annuity for the life of a participant with a survivor annuity for the life of the participant's spouse that is equato a specified applicable percentage of the amount of the annuity that is payable during the joint lives of the participant and the spouse and that is the actuarial equivalent of a single life annuity for the life of the participant. The specified applicable percentage of spousal coverage for a QOSA depends on the level of spousal coverage under the QJSA. If the QJSA spousal coverage is less than 75%, then the QOSA percentage must be 75%, and if the QJSA spousal coverage is equal to, or greater than, 75%, the QOSA percentage is 50%.

The Notice provides that if the plan is already providing an option that meets the QOSA requirements, the plan does not need to be amended to designate such an option as a QOSA nor does the administration of the plan need to be amended to designate the optional form as a QOSA. The Notice also describes how to satisfy the requirement of a written explanation of the terms and conditions of a QOSA by following Treas. Reg. § 1.417(a)(3)-1.

The Notice clarifies that under Section 417, a participant who waives the QJSA may elect the QOSA during the applicable election period, and spousal consent is not required to elect the QOSA as a form of distribution pursuant to Treas. Reg. § 1.401(a)-20, Q&A-16, unless the QOSA is not at least actuarially equivalent to the QJSA. In regards to pre-retirement survivor annuities, the Notice indicates that a plan offering a pre-retirement survivor annuity does not also have to offer a pre-retirement annuity based on a QOSA.

Transition to New Applicable Mortality Table and Applicable Interest Rate

Section 417(e)(3), which provides rules for the determination of the present value of benefits for purposes of Section 417(e)requires that the present value not be less than the present value calculated using the applicable mortality table and the applicable interest rate as defined under Section 417(e)(3)(B) and (C). For plan years beginning on or after January 1, 2008, there are new requirements for the applicable interest rate and applicable mortality table (PPA factors), which replace those previously applicable (GATT factors). (See Rev. Rul. 2007-67 for additional guidance regarding this change.) Many plan sponsors have been interested in cushioning the transition to PPA factors by providing participants with the better of the two sets of factors for a limited period. There have been outstanding issues with such approach, though, which the Notice now addresses.

The Notice clarifies that for a limited period (generally through the 2009 plan year) a plan will not fail to satisfy the requirement that a QJSA for a married participant be at least as valuable as any other form of benefit payable under the plan at the same time merely because the amount payable under an option subject to Section 417(e)(3) is based on the PPA factors or the GATT factors, whichever is more favorable. The Notice also provides that the Section 411(d)(6) cutback relief in PPA Section 1107 will apply to such provisions, but indicates that such cutback relief only applies to the first amendment which implements the PPA factors (disregarding amendments adopted on or before June 30, 2008).

Complying with the Requirement of Distributing Gap-Period Earnings

The Notice clarifies that plans submitted during Cycles B and C of the determination letter review process are required to provide for the inclusion of gap-period earnings when distributing excess deferrals. (See Rev. Proc. 2007-44 for more information.) Furthermore, interim plan amendments are not required to be adopted until the last day of the first plan year beginning on or after January 1, 2009. Although the interim plan amendment requirement has been delayed, plans are required to include gap-period earnings in the distribution of excess deferrals attributable to tax years beginning on or after January 1, 2007.

Health & Welfare: Treasury Department Issues Guidance on Supplemental Health Insurance

Susan Relland & Patricia Szoeke

The Treasury Department recently issued Notice 2008-23 providing guidance on when supplemental health insurance would be treated as an excepted benefit under HIPAA (and therefore not subject to HIPAA's portability and nondiscrimination rules). HIPAA imposes rules regarding limitations on preexisting condition exclusions, issuance of certificates of creditable coverage, special enrollment rights, and discrimination on the basis of any health factor. These provisions, however, do not apply to certain excepted benefits, one category of which is supplemental excepted benefits.

Notice 2008-23 provides a safe harbor under which supplemental health insurance coverage that meets the following criteria will qualify as an excepted benefit under HIPAA:

- The coverage is provided through a policy, certificate, or contract of insurance separate from the primary coverage under the plan;
- The supplemental policy, certificate, or contract of insurance was issued by an entity that does not provide the primary coverage under the plan (for this purpose, entities that are part of the same controlled group of corporation or under common control, within the meaning of Code Section 52(a) or (b) are considered a single entity);
- The supplemental policy, certificate, or contract of insurance is specifically designed to fill gaps in primary coverage (e.g., coinsurance, deductibles) but does not include a policy, certificate, or contract of insurance that becomes secondary or supplemental only under a coordination-of-benefits provision;
- The cost of coverage under the supplemental policy, certificate, or contract of insurance may not exceed 15% of the cost of primary coverage (with cost being determined in the same manner as the applicable premium is calculated under a COBRA continuation provision); and
- The supplemental policy, certificate, or contract of insurance that is group health insurance coverage is not different among individuals in eligibility, benefits, or premiums based on any factor of an individual (or any dependent of the individual).

Supplemental health insurance coverage not meeting these criteria is subject to further examination as to whether it qualifies as "similar supplemental coverage to coverage under a group health plan" and therefore subject to the portability and nondiscrimination requirements. As the Departments of Treasury, Labor, and Health and Human Services have joint jurisdiction over HIPAA, all three agencies are developing similar notices (see DOL Field Assistance Bulletin 2007-4) and expect this safe harbor to be incorporated as a requirement (as opposed to a safe harbor) in a future proposed rulemaking.

Payroll Tax & Fringe Benefits

Fred Oliphant & Patricia Szoeke

Code Section 132 provides the framework for the tax treatment of some of the most common types of fringe benefits provided by employers. However, whether non-employee directors are eligible to receive such benefits on a non-taxable basis depends on the type of fringe benefit being provided.

Generally, the most common type of fringe benefits employers provide on a non-taxable basis are no-additional-cost services, qualified employee discounts, working condition fringes, and de minimis fringes. Section 132 provides that these fringe benefits may be provided on a non-taxable basis only to "employees" of the employer. However, the definition of "employee" in the fringe benefit regulations differs in the scope of its coverage, depending on the type of fringe benefit.

Under one definition of "employee," non-employee directors are not eligible to receive a no-additional-cost service or a qualified employee discount on a non-taxable basis. See Treas. Reg. § 1.132-1(b)(1). However, applying a different definition of "employee," the regulations provide that an employer may provide a working condition fringe or a de minimis fringe to a non-employee director on a non-taxable basis. See Treas. Reg. § 1.132-1(b)(2) and (4).

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