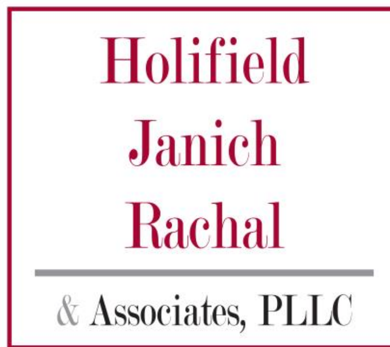

Legal Update for Employers

As a service to our clients, Holifield Janich Rachal & Associates, PLLC periodically issues a newsletter to keep you informed of developments in statutes, regulations and case law that may impact you. If you would like assistance or further information about any of the matters described in this update, please contact us and we will be happy to discuss these issues with you further.

U.S. Department of Labor Wins Big in First Ruling on Its New Fiduciary Rule*

By Robert Rachal

*The ABA Section of Labor & Employment Law published a version of this article in the Employee Benefits Committee Newsletter (Winter 2016) of the ABA Section of Labor & Employment Law, and is reprinted here with permission.

Since 2009 the U.S. Department of Labor (DOL) has been investigating redefining what constitutes fiduciary conduct for rendering investment advice for a fee. The prior DOL rule, promulgated in 1975, construed this conduct narrowly, including by requiring that the advice be (i) on a regular basis and (ii) rendered pursuant to a mutual agreement that the advice will serve as the primary basis for investment decisions with respect to plan assets. In 1975 defined benefit plans were the predominant retirement vehicle, and these were typically managed by a company's financial personnel. Since 1975, however, there has been explosive growth (i) in defined contribution plans that places the (often financially unsophisticated) individual participant at the center of investment decisions, and (ii) in the complexity of financial products offered these participants.

These and other concerns led the DOL to seek to expand the definition of fiduciary conduct in this area. After an extensive rulemaking process, the DOL promulgated its new final rule in April 2016. This new rule has been subjected to numerous legal and now political challenges. On the political

front, there is a proposed delay of the rule to consider concerns raised by the new Trump administration.

On the legal front there have been over six lawsuits filed, several of which were consolidated in federal court in the Northern District of Texas before Judge Barbara M.G. Lynn, in *U.S. Chamber of Commerce v. Hugler*, 2017 WL 514424 (N.D. TX, Feb. 8, 2017), and in a case filed in Kansas, *Market Synergy Group v. U.S. Department of Labor*, 2016 WL 6948061 (D. Kan., Nov. 28, 2016).

The DOL won each of these cases. This article focuses on the first major ruling on these challenges, *Nat'l Ass'n for Fixed Annuities v. Perez*, 2016 WL 6573480 (D.C.D.C., Nov. 4, 2016). In *National Association for Fixed Annuities* the DOL won a substantial victory against various challenges brought by the National Association for Fixed Annuities (NAFA). Among other things, the new rule expanded the definition of fiduciary conduct by dropping the old rules' requirement that such investment advice must occur "on a regular basis" to be fiduciary advice. Thus, advice on major participant financial decisions affecting retirement, such as whether to roll over their 401(k) funds to an IRA, and in what investments to invest those funds, will now be typically fiduciary advice under the new rule. The DOL estimates that participants will roll over $2 trillion in retirement funds during the next five years, so the financial significance of this change to participants and to those who advise them is obvious.

***Chevron* Analysis**. In perhaps the most significant part of his decision, Judge Randolph Moss concluded that the new rule more closely conforms to the statutory text than the old rule. Thus, Judge Moss found the new rule easily passed "step one" of *Chevron* analysis, since Congress obviously has not foreclosed the DOL's interpretation. Rather, "[n]othing in the phrase 'renders investment advice' suggests that the statute applies only to 'advice on a regular basis.'"*Id.* at *15. In response to arguments by NAFA that Congress only intended to apply fiduciary duties to those who participate in ongoing management of a plan or its assets, Judge Moss noted that Congress placed the requirements to administer or manage the plan in the *other* prongs of the fiduciary definition, not the one applicable to investment advice for a fee. Judge Moss reasoned that adding these requirements to the investment advice prong would thus strip it of meaning.

Judge Moss also concluded that the DOL's new rule easily passed step two of *Chevron's* analysis – that its interpretation is reasonable and reasonably explained. Judge Moss noted that the new rule better comports to the statutory text and to ERISA's broadly protective purposes, which imposes fiduciary standards on those whose actions affect the amount of benefits retirees will receive. The DOL reasonably explained that the relationships between advisors and investors have changed since 1975, with the rise (i) in 401(k) plans and IRAs, which often put the individual participant at the center of the investment decisions, and (ii) in the complexity of the products offered these participants.

Expansion to IRAs. NAFA also challenged the DOL's application of fiduciary duties to IRAs (which are regulated under Title II of ERISA) through the Best Interest Contract Exemption (BIC Exemption) and Prohibited Transaction Exemption (PTE) 84-24. NAFA argued that since Congress did not apply fiduciary duties to IRAs by statute, the DOL could not do so through rulemaking. Judge Moss rejected this argument, finding that what the DOL did was a permissible exercise of its rulemaking authority under Title II to require certain conditions be met – in this case

agreement to comply with fiduciary standards of loyalty and prudence – before an exemption would be granted.

Judge Moss concluded that NAFA's structural argument, that Congress put fiduciary duties only in Title I not Title II, while having more merit, ultimately failed because nothing in Title II unambiguously foreclosed inclusion of fiduciary duties as a condition of an exemption. Rather Congress required that exemptions have to be (i) administratively feasible, (ii) in the interests of the plan and its participants, and (iii) protective of the rights of the participants. And since the beginning of ERISA the DOL has used its authority to impose substantive conditions on exemptions. Here, Judge Moss observed that the BIC Exemption may not have passed muster as being in the interests of participants absent imposition of fiduciary duties of loyalty and prudence, since without these enforceable duties commissions permitted by this exemption can risk incentivizing advisors to favor their interests over those of participants.

Private Cause of Action. NAFA argued that requiring an IRA adviser to agree to enter contracts with certain terms to qualify for the BIC Exemption, meant that this exemption violates the rule that only Congress can create a private cause of action. Judge Moss rejected this argument, noting that the DOL has elsewhere required inclusion of contractual terms to qualify for exemptions, and that the enforceability of the contracts will be determined under and pursuant to state law, not the DOL's rule. Judge Moss also noted that this approach fits within the enforcement scheme for IRAs, which are enforced under state contract and common law, and that the DOL simply conditioned its exemption on inclusion of certain terms (enforceable by state law causes of action) in those contracts.

Reasonable Compensation as too Vague. NAFA argued that the BIC requirement that the advisor receive no more than reasonable compensation was void for vagueness. In response to comments, in the final rule the DOL cross-referenced the BIC's "reasonable compensation" standard to the one used elsewhere in ERISA. Judge Moss agreed the standard was sufficiently clear in context that a reasonably prudent person would know what conduct was prohibited. Judge Moss noted that the harm this standard was meant to mitigate – conflicts of interest caused by certain compensation structures – gave further meaning to the standard, and to what was prohibited. Judge Moss also noted that the term "reasonable" is used throughout the law, and "reasonable compensation" is used repeatedly in ERISA and in trust law on which it is based.

Requiring Fixed Indexed Annuities to Meet the BIC Exemption. In the final rule the DOL decided to require fixed indexed annuities (these are annuities in which the payments vary based on investment returns, but with protection from negative returns) to be subject to the BIC Exemption, not merely PTE 84-24. Judge Moss found that this placement was not "arbitrary or capricious" since the DOL could reasonably conclude that the risks and complexities associated with this product justified the need for these added protections. In response to NAFA's claims that these changes would cause market disruptions in distributing this product, Judge Moss noted that the DOL could conclude (i) that the harms to participants from conflicted advice outweighed this, and (ii) that the United Kingdom's experience with similar reforms suggested that most advisers would stay in the market.

Perspectives. While there will be many more legal battles over the DOL's new fiduciary rule, this ruling was an unambiguous major win for the DOL. If Judge Wood's *Chevron* analysis continues to be followed by the courts, the legal battles for the DOL likely will be downhill. If, per Judge

Wood, the DOL is correct that fiduciary conduct is properly defined broadly in relation to providing investment advice for a fee, then it appears that the providers may need BIC (or some other exemption) to avoid prohibited transactions for transaction-based compensation. Yet the DOL can promulgate exemptions only if they are in the interests of and protective of the rights of participants, so the DOL will have statutory justification to impose conditions on the exemption to protect participants from conflicts. The political battles on this new rule may be just beginning however.

Litigation Alert – Class action COBRA lawsuits.

By: Tina Haley

There is a growing trend of plaintiffs filing class action lawsuits against health plans and their administrators seeking statutory penalties and other damages for deficient COBRA notices. The majority of these class actions challenge the content of the COBRA notice.

COBRA regulations require plan administrators of group health plans to provide plan participants notice of their rights under COBRA, including when such rights arise and how to elect COBRA continuation coverage. The U.S. Department of Labor has provided a model COBRA notice that meets the regulatory notice requirements. Use of the model notice is voluntary, but plan administrators run the risk of self-drafted notices falling short of meeting these requirements.

One such lawsuit against SunTrust Banks recently settled for $290,000. In *Gilbert v. SunTrust Banks*, plaintiff alleged that the COBRA notice distributed by SunTrust was deficient because (i) it failed to provide a name and address of the party responsible for administration of COBRA coverage under the health plan, (ii) failed to adequately explain procedures of electing continuation coverage, and (iii) only directed participants to a general human resource website and telephone number for additional information. The District Court in the Southern District of Florida approved settlement of the lawsuit which required SunTrust to revise its COBRA notice to specifically identify the party responsible for administration of COBRA coverage, identify the specific location on the human resources website where COBRA information and forms could be found, and notify participants of an alternate method to receive the COBRA election form upon request.

Other pending federal class actions include class action lawsuits filed in 2016 against Wal-Mart (Southern District of Florida), Shipcom Wireless (Southern District of Texas) and BB&T (Middle District of Florida). In each of these cases, plaintiffs allege either that no COBRA notices were provided, or that the notices deviated from the DOL model notice and fell short of the statutory requirements by failing to provide adequate information.

In light of this increased litigation, we recommend that employers review their COBRA notices and procedures to ensure compliance with all notice requirements. Please contact us to determine whether your notices are compliant.

ACA Information Reporting Deadlines Extended

The Internal Revenue Service has extended the deadlines for employers to furnish information statements to employees. The IRS did not extend the deadline for employers to file returns with the IRS.

Form 1095-C: This is the form provided by "applicable large employers" to employees with information about the coverage offered. The form is also filed with the IRS using Form 1094-C transmittal form. The deadline to provide this form to employees has been extended from January 31, 2017 to March 2, 2017. The deadline for filing the form with the IRS remains February 28, 2017, or March 31, 2017 if filing electronically.

Form 1095-B: This is the form provided to covered individuals by providers of minimum essential coverage, including employers who are not "applicable large employers," but offer employer-sponsored self-insured health coverage. The form is filed with the IRS using Form 1094-B transmittal form. The deadline to provide this form to covered individuals has been extended from January 31, 2017 to March 2, 2017. The deadline for filing the form with the IRS remains February 28, 2017, or March 31, 2017 if filing electronically.

Please contact us if you need assistance in completing and filing these required forms.

21st Century Cures Act Allows Greater Use of Health Reimbursement Arrangements by Small Employers

On December 13, 2016, President Obama signed the 21st Century Cures Act into law. The Act addresses several issues including planned guidance programs for compliance with the Mental Health Parity Act and a new health reimbursement arrangement (HRA) vehicle for small employers. Specifically, the Act provides an exception from the group health plan requirements of the Affordable Care Act for "Qualified Small Employer Health Reimbursement Arrangements" (QSEHRA). In Notice 2015-17, the IRS stated that health reimbursement arrangements violated the ACA's market reforms unless certain requirements were met (such as "integrating" the HRA with an employer ACA-compliant group health plan such that employees could not participate in the HRA without participating in the group health plan). For small employers who were not subject to the ACA (because they were not "applicable large employers"), this guidance meant that such employer could not offer health reimbursement arrangements.

Beginning January 1, 2017, the Act provides certain small employers the opportunity to offer their employees an HRA in spite of this guidance. An employer is eligible to fund a QSEHRA if:

1. it is not an "applicable large employer" under the ACA employer mandate rules (meaning it does not have 50 or more full-time employees, including full-time equivalents); and

2. it does not offer a group health plan to any of its employees.

The QSEHRA offered by the small employer must meet the following requirements:

1. it must be provided on the same terms to all eligible employees; employers may exclude

employees (i) who have not completed 90 days of service, (ii) are under age 25, (iii) are part-time or seasonal employees, (iv) are covered by a collective bargaining agreement if accident and health benefits were the subject of good faith bargaining, and (v) nonresident aliens with no earned income from sources within the United States;

2. it must be funded solely by the employer and no salary reduction contributions may be made; and

3. it must provide for payment or reimbursement of medical care expenses (as defined in Internal Revenue Code Section 213(d)) or premiums for individual health coverage incurred by the employee or their family members.

Payments or reimbursements made by a QSEHRA for a year are limited to $4,950 for employee-only coverage or $10,000 for family coverage. These limits will be indexed for inflation and prorated for employees who are not covered for an entire year.

The employer must also provide notice to employees eligible to participate in a QSEHRA no later than ninety (90) days before the beginning of each plan year and, for those who become eligible during the year, on the date such employee becomes eligible. The notice must contain the following information:

1. the amount of the employee's permitted benefit for the year;

2. a statement that the employee should provide specified information to any ACA health insurance exchange to which the employee applies for advance payment of the premium assistance tax credit; and

3. a statement that if the employee is not covered under minimum essential coverage for any month, the employee may be subject to a tax under the individual mandate provisions of the ACA or reimbursements under the QSEHRA may be included in gross income.

This option for small employers came a little too late for the 2017 benefit year. However, it is an option that eligible small employers may want to consider for the future.

Reminder regarding annual limits for health flexible spending accounts.

The limit for employee salary deferrals under a health flexible spending account has increased from $2,550 to $2,600 for 2017. If your health FSA plan document does not state a specific maximum, but instead refers to the limit as provided in Internal Revenue Code § 125(i), the maximum automatically increases each year if the IRS announces a new limit. We recommend that you review your health FSA plan document to confirm the limit for your plan for 2017 and ensure that individuals or entities responsible for plan administration (such as third-party administrators) are aware of the new limit.

Disney and *Chevron* 401(k) Fee Litigation: Court Skepticism Can Provide Some Important Limits to Fee Litigation*

By Robert Rachal

*The complete version of this article is published in Bloomberg BNA Pension & Benefits Daily (Nov. 30, 2016).

There has been a substantial recent uptick in settlements, judgments and in cases filed challenging fees and the prudence of investments offered in 401(k) and now 403(b) plans. But recent court rulings in *In re Disney ERISA Litigation,* No. CV 16-2251 PA (JCx) (C.D. Cal., Nov. 14, 2016), and in *White v. Chevron Corp.* (N.D. Cal., Aug. 29, 2016), indicate that some courts are taking a harder look at these claims, rejecting use of hindsight and plaintiffs' *per se* cost-focused rules to judge investments. These courts rejected adoption of any "assumption of imprudence" based solely on allegations of costs. If followed, *Disney* and *Chevron* may provide significant ways to limit the adverse impacts of this rising fee litigation.

Disney

In *In re Disney ERISA Litigation,* a consortium of experienced ERISA plaintiffs' counsel challenged Disney's inclusion of the Sequoia Fund as an investment option in Disney's 401(k) plan, principally because this mutual fund had concentrated investments in Valeant Pharmaceuticals' stock, which suffered substantial losses in late 2015. According to plaintiffs, the Disney plan should have removed this fund at some unspecified time before then because there were serious concerns and questions about Valeant's business model and accounting methods in the public domain *before* Valeant's stock begin its precipitous decline in October 2015.

The district court caught the flaw in this theory, *i.e.*, since the stock price had stayed up after these disclosures, other market investors had rejected these concerns and instead saw positive prospects in the company. In perhaps the most significant part of its decision, the court relied on the U.S. Supreme Court's decision in *Fifth Third Bancorp v. Dudenhoeffer,* 134 S. Ct. 2459 (2014), to conclude that (i) procedurally, motions to dismiss are an important mechanism to weed out meritless claims challenging the prudence of plan investments, and (ii) substantively, allegations that a fiduciary should have discerned that the market was over or undervaluing stock are, as a general rule, implausible absent special circumstances suggesting flaws in the market's ability to price securities. The court found no facts suggesting this.

Chevron

Chevron v. White appears to be a case in which a lead plaintiff's firm in ERISA fee litigation, Schlichter, Bogard & Denton, sought to push the envelope. Chevron has a very large 401(k) plan with $19 billion in assets as of December 31, 2014, with an overall low-cost fee structure. Plaintiffs principally challenged discrete practices, effectively arguing for applying *per se* cost-focused rules in plan management. The district court rejected these challenges:

• ***Stable value instead of money market funds***. Plaintiffs argued that plans should offer stable value funds instead of money market funds as the capital preservation option since they had outperformed money market funds in the current low interest rate environment. The court stated that it was not going to infer an imprudent process from the plan's failure to include a stable value fund.

• ***Claims could have offered cheaper investment options***. Again, the court was not going to infer an imprudent process because the plan was not limited to institutional class funds or collective trusts. The court instead noted that plaintiffs' own allegations suggested that the plan fiduciaries were periodically monitoring fund costs, including by moving to lower cost funds, and by offering a diverse mix of investment options, including low cost funds.

• ***Claims imprudent to use asset-based fees to compensate record keepers***. Plaintiffs argued it was imprudent to use asset-based fees to compensate the plan's record keeper, particularly since the assets increased 22% during the 2010 to 2012 period in which it was in place. The court noted that there was no prohibition against using revenue sharing to compensate record keepers, and that the allegations showed that defendants were monitoring these costs, including eliminating funds that provided revenue sharing and moving to a per-participant fee structure after two years.

Perspectives

From the defense perspective, *Disney* and *Chevron* can be important cases to provide some needed limits on fee litigation. On procedure, applying *Dudenhoeffer's*aggressive use of motions to dismiss to weed out meritless claims can save plan fiduciaries from burdensome litigation, which otherwise can too often force changes in plan practices regardless of the ultimate merits of the claims.

On substance, the *Disney* and *Chevron* courts rejected adoption of "assumptions of imprudence" or similar *per se* rules that could have substantial untoward consequences regarding plan investments. The U.S. Department of Labor and the courts long ago observed that cost should *not* be the only criteria to evaluate plan investments and plan providers. The courts' rulings gave effect to this, by requiring valid claims of fiduciary breach to contain something more than bald claims that cheaper funds or alternatives may have been available.

Holifield Janich Rachal & Associates is pleased to announce:

Best Lawyers® named Robert Rachal the 2017 Litigation-ERISA "Lawyer of the Year" for New Orleans.

Pittington v. Great Smoky Mountain Lumberjack Feud. Al Holifield and Tina Haley successfully obtained a dismissal of an employee's claims of discrimination and retaliation under Title VII. Each of the employee's claims were dismissed by the District Court prior to trial.

Robert Rachal with his former colleagues at Proskauer recently submitted an *amicus* brief to the U.S. Supreme Court for a group of Catholic health organizations on the scope of the "church plan" exemption to ERISA.

Holifield Janich Rachal & Associates will be putting on a seminar in conjunction with USI in New Orleans on May 11, 2017 for employers regarding their employee benefit plans. Speakers include industry leaders who will provide you with an update on legal compliance, case law and other important issues human resource professionals desire to know regarding their company's benefit plans, including 401(k) and 403(b) plans. If you are interested in attending, please contact Tammy Call at tcall@holifieldlaw.com.

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