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Plans Faced with Conflicting Claims Ordered to Pay Twice

A recent case decided by the U.S. Court of Appeals for the 10th Circuit illustrates two important lessons for plan administrators: (1) plan procedures should be followed faithfully; and (2) when notified of a competing claim for benefits, a plan would be well-advised to investigate and ascertain the validity of the claim before paying any benefits. Failure to heed these principles may result in double-payment liability for the plan, as in the following case. Reversing a New Mexico district court, the 10th Circuit ruled that a plan administrator improperly paid benefits from two Code Section 401(k) plans to a deceased participant's children after receiving notice of a potential claim for spousal benefits from a woman claiming to be the participant's common-law spouse. The plan administrator relied on a completed beneficiary designation naming the participant's children as his beneficiaries and claiming that he was not married. Shortly after payments commenced to the participant's children, the plan received notice that the participant's long-time companion had filed a petition to have her common-law marriage to the participant validated under Navajo law. Because common-law marriages deemed valid in other jurisdictions are recognized under New Mexico law, a person deemed to be a common-law spouse under Navajo law would be entitled to benefits under the plans as a surviving spouse. Following validation of her spousal status, the spouse sued to recover amounts that had been paid to the participant's children after notification of her claim to the benefits. The lower court ruled in favor of the plans, finding it was not arbitrary and capricious at the time the benefits were paid for the plans to determine that there was no surviving spouse. On appeal, the 10th Circuit reversed, ordering the plans to pay spousal benefits to the common-law spouse. The court found the administrator's decision to pay benefits to the children was unreasonable even under the "arbitrary and capricious" standard. The court quoted the plans' own procedures, which imposed limits on the right of an administrator to rely on an employee's affirmation of marital status: "*Absent conflicting information or knowledge to the contrary*, the administrator has no obligation to ascertain whether or not an employee is married." Finding that the plans did not follow their own procedures regarding conflicting information, the court concluded that once the plans received the plaintiff's hand-delivered Stipulation for Validation of Marriage in the Navajo Nation Family Court, the administrator was required to ascertain whether the participant was married, and that the only way to "ascertain" this fact was to wait for the outcome of the legal proceedings. *Smith v. New Mexico Coal 401(k) Personal Savings Plan* (10th Cir. 2009)

No Fiduciary Breach Where Plans Included Company Stock as Investment Option

Decisions in two recent cases coming out of the Northern District of Illinois are good reminders that retirement plan fiduciaries do not necessarily breach their duties by continuing to offer company stock as an investment option, even where there has been a significant drop in the value of the stock. Nonetheless, fiduciaries for plans that offer company stock as an investment option must be diligent in the performance of their fiduciary duties as they relate to investing plan assets in company stock.

In *Brieger v. Tellabs, Inc.*, participants in the Tellabs profit sharing and savings plan filed a class-action lawsuit against Tellabs and various individual defendants in connection with the offering of Tellabs common stock as an investment option. Tellabs stock was one of several investment options offered to plan participants. Tellabs experienced a market downturn, and its stock value declined from $63.19 per share to $6.58 per share. The lawsuit alleged various fiduciary breaches, including a breach of the fiduciary duty of prudence and a breach of the fiduciary duty to disclose. Following a trial on the merits, the court ruled in favor of defendants, holding that plaintiffs did not establish that the defendants were procedurally imprudent in allowing the plan to continue offering Tellabs stock as an investment option; that plaintiffs did not establish that a prudent fiduciary, under the circumstances, was required to sell the Tellabs stock and halt further contributions to the Tellabs stock fund; that defendants did not make any material misrepresentations or withhold any material information that plaintiffs needed to make informed decisions about their investment selections; that the plaintiffs failed to prove by a preponderance of the evidence that the defendants breached their duty of loyalty; and that the plaintiff's claims, even if they had been properly established, are barred because the lawsuit

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was not filed within the applicable statute of limitations under the Employee Retirement Income Security Act (ERISA).

In *Lingis v. Motorola, Inc.*, participants in Motorola's 401(k) plan filed a class-action lawsuit against Motorola and various individual defendants in connection with the offering of Motorola common stock as an investment option. In the late 1990s, Motorola made loans to a Turkish telecommunications company, Telsim, totaling approximately $2 billion. In 2001, Telsim defaulted on its loan payments. At least in part because of those defaults, the price of Motorola stock plummeted. Plaintiffs filed suit, claiming that defendants breached their fiduciary duties by continuing to offer Motorola stock as an investment option in the 401(k) plan and by misrepresenting Motorola's financial health. The court granted a motion for summary judgment in favor of Motorola. In reaching its decision, the court ruled that the ERISA 404(c) safe harbor for plans in which participants exercise control over their own investments relieves the defendants of liability. In so ruling, the court rejected plaintiffs' claims that they could not exercise independent control because of an alleged failure to disclose information concerning the Telsim deal. The court also ruled that plaintiffs failed to establish the existence of a genuine dispute as to the prudence of continuing to offer Motorola stock as an investment option because plaintiffs produced no evidence of extraordinary circumstances such as Motorola being on the verge of collapse or Motorola having an elderly workforce with a substantial interest in less risky investments.

Taxation of Employer-Paid Cell Phones

The IRS has issued Notice 2009-46 to seek comments on its proposal to determine the amount, if any, that an employee must include in gross income if the employee is provided an employer-paid cell phone or other similar telecommunication device. The IRS has based this proposal on its conclusion that an employee receives a taxable fringe benefit if the employer provides the employee with a cell phone or other device that can be used for personal purposes. The notice states that the IRS is considering three methods to determine the application of the fringe benefit rules: (1) No taxable benefit if the employer can meet requirements to show that any personal use by the employee is "minimal"; (2) a "safe harbor" rule whereby an employer-provided device would be treated as providing 25 percent of usage as a fringe benefit; and (3) a statistical sampling method that would be used to calculate personal usage that is taxable. Comments from any interested person can be submitted to the IRS, including e-mail comments to: notice.comments@irscounsel.treas.gov. E-mail comments should refer to "Notice 2009-46" in the subject line and should be sent by September 4, 2009.

Carelessness Can Be Costly

A recent summary judgment order in a federal court underscores the value of the careful handling of ERISA claims. Following a major acquisition, an employee found her job with the acquired company had been eliminated in the acquisition. She was covered by a severance pay plan that provided benefits if the covered employee lost employment as a result of an acquisition unless the employee was offered a comparable position in the ongoing company. The employee was offered a continuing job with a similar title and the same pay, and she took the new position. After three months in the new job, the employee left the company and applied for severance benefits. The severance pay plan had a requirement that if an offer of continued employment was not "comparable," the severance benefits would be available only if the employee notified the Human Resources Department of a rejection of the offer within two weeks after the offer is made. The employee's claim for severance benefits played out under the severance pay plan claims procedure and was ultimately rejected on the basis that the new job, with the similar title and same pay, was a comparable position. The rejection never mentioned that the employee did not meet the two-week rule and in fact had accepted the job and continued in the new position for about 12 weeks. The employee filed a lawsuit and was able to effectively argue that the new position was not comparable to her old job. The company's attempt to introduce the plan's explicit two-week rule as an alternative basis for denying benefits was rejected because it was never raised earlier in the process. The court's award to the employee of benefits under the plan and an award of her attorney's fees is an expensive lesson that deliberate, careful handling of the severance pay claim under the plan would have brought a different conclusion. *Nair v. Pfizer Inc.* (D.N.J. 2009)

Plan Can Seek Recoupment of Overpaid Pension Benefits

In a recent case, a federal district court held that a multiemployer pension plan can sue a former participant for the return of benefits in excess of the benefits to which he was entitled. The participant/defendant in this case retired from employment in the industry covered by the plan and elected to receive payment of his retirement benefit in the form of a single sum payment of approximately $79,000. The plan alleges that the employee agreed, as part of his application for benefits, that he would repay the lump sum with interest if he returned to work in the industry. Moreover, it appears that the governing plan document expressly required repayment of the lump sum benefit under these circumstances. When the participant returned to employment in the industry, and refused

to repay his lump sum, the plan sued him. One of the defenses asserted by the participant/defendant was that ERISA does not authorize a plan to sue a participant for the return of improper or excess payments unless the plan can trace the improper or excess payments to specific funds in the participant's possession. In other words, once the improperly paid amounts have been spent, or commingled with a participant's other assets, the plan has no remedy. Citing the U.S. Supreme Court's decision in *Sereboff v. MidAtlantic Servs., Inc.*, the plan argued that the so-called "tracing" requirement advocated by the participant is not required when the governing plan documents specifically identify (a) a particular fund distinct from the participant's assets (here, the lump sum payment), and (b) a particular share of that fund to which the plan is entitled (in this case, the entire amount). The court agreed with the plan and ruled that the claim could proceed even if the plan could not establish that the lump sum payment was specifically identifiable in the hands of the participant (i.e., held separately from the participant's personal funds). We should emphasize that not all courts have addressed this issue. However, to maintain a viable cause of action against a participant for the return of excess or improper benefit payments, a plan document must, at a minimum, identify a particular fund distinct from the participant's assets and the share of that fund to which the plan is entitled. Plan fiduciaries have a duty to pursue improper payments from plan assets. Arguably, this duty includes ensuring that plan provisions expressly reflect the fiduciaries' right to do so. (*Board of Trustees for the Hampton Roads Shipping Ass'n — International Longshoremen's Ass'n v. Stokely*, ED Va. 2009)

401(k) Loan Not Treated as Secured Debt or Necessary Expense for Individual's Bankruptcy

Following the adoption of the Bankruptcy Abuse Prevention and Consumer Perception Act of 2005, a "means test" was adopted to evaluate whether relief should be granted to an individual under Chapter 7 of the Bankruptcy Code. In a Chapter 7 proceeding, the bankruptcy trustee gathers and sells the debtor's nonexempt assets and uses the proceeds to pay holders of claims (creditors) in accordance with the provisions of the Bankruptcy Code. A Chapter 7 bankruptcy case does not involve the filing of a plan of repayment, as in Chapter 13. A Chapter 13 bankruptcy requires individuals with regular income to develop a plan to repay all or part of their debts. Under Chapter 13, debtors propose a repayment plan to make installments to creditors over three to five years. The debtor may rebut a presumption of abuse to qualify for Chapter 7 relief only by a showing of special circumstances that justify additional expenses or adjustments of current monthly income. Unless the debtor overcomes the presumption of abuse, the case will generally be converted to Chapter 13 (with the debtor's consent) or will be dismissed.

The U.S. Court of Appeals for the Ninth Circuit examined the treatment of 401(k) loans in a recent case. The debtor had taken a loan from his 401(k) plan and was repaying $733.90 each month. The debtor listed the loan repayment as part of "necessary expenses" and declared that after all debts were paid each month, he had monthly disposable income of $15. The bankruptcy trustee objected to characterizing the loan as a necessary expense and, with that re-characterization, the debtor would not qualify for Chapter 7 relief. The Ninth Circuit determined that the debtor failed the means test because the 401(k) loan was not a secured debt because the obligation to repay the loan is secured by the debtor's 401(k) account and is essentially a loan from the debtor to himself. Failure to repay the loan would be treated as a taxable distribution and would not subject the individual to requirement of personally repaying the funds. Additionally, the Ninth Circuit determined that the plan loan was not an "other necessary expense," rejecting the debtor's argument that maintaining the value of his 401(k) plan account was necessary to his health and welfare because he was approaching retirement age. (*In re Egebjerg, 9th Cir.*, 2009)

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