



A report to clients and friends of the firm

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in this issue

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Editor's Overview 1

ERISA Preemption after *Gobeille v. Liberty Mutual Ins. Co.* 1

Sun Capital Court Finds Co-Investing Funds Part of Controlled Group and Liable for Portfolio Company's Pension Liabilities 4

U.S. Department of Labor Finalizes Fiduciary Definition and Conflict of Interest Rule 5

Rulings, Filings, and Settlements of Interest 15

Editor's Overview

This month we feature three key developments. First, we review the U.S. Supreme Court's decision in *Gobeille v. Liberty Mut. Ins. Co.*, 136 S. Ct. 936, 947 (2016) wherein the Supreme Court held that a Vermont statute requiring "all payers" to report healthcare information to the State of Vermont was preempted by ERISA. Second, we review the latest chapter in *Sun Capital* where the district court determined that co-investing funds that were part of the same controlled group were liable for a portfolio company's pension liabilities. Third, for those that missed it, we re-publish our recent Client Alert on the DOL's final conflict of interest rule.

As always, we conclude with Rulings, Filings, and Settlements of Interest where we highlight issues on employer stock drop litigation, retiree health benefits litigation and forum selection clauses.

ERISA Preemption after *Gobeille v. Liberty Mutual Ins. Co.* *

By Robert Sheppard

The U.S. Supreme Court recently struck down a Vermont statute requiring "all payers"—i.e., healthcare providers, insurers, and facilities—to report healthcare information to the State of Vermont on the ground that the statute was preempted by the Employee Retirement Income Security Act of 1974 ("ERISA"). In this article, we review the Court's decision and also provide some perspective on the potential implications of the decision for plan sponsors and fiduciaries.

Background

Many states have developed and implemented all-payer claims databases to address their need for comprehensive healthcare information, including costs, quality, utilization patterns, and access and barriers to care. One purpose behind these initiatives is to provide consumers and purchasers of healthcare services the ability to compare prices and quality as they make healthcare decisions.

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There has been no question about the ability of states to acquire such information from insured plans. Although ERISA preempts "any and all State laws insofar as they may now or hereafter relate to any employee benefit plan," 29 U.S.C. § 1144(a), ERISA's "savings clause," saves from ERISA preemption state laws regulating insurance, banking, or securities. But ERISA's "deemer" clause prevents a state from deeming a self-insured ERISA plan "an insurance company or other insurer, bank, trust company, or investment company" for the purposes of regulating it.

In 2008, Vermont passed legislation establishing an all-payer claims database. Vt. Stat. Ann. tit. 18, §9410. The statute provided for the Vermont Healthcare Claims Uniform Reporting and Evaluation System (a newly created agency) to compile claims information from self-funded and fully insured plans into a database with the purpose of showing "all health care utilization, costs and resources" available and provided in the State. The database was designed to enable Vermont "to determine the capacity of existing resources, identify health care needs, evaluate effectiveness, compare costs, provide information to consumers and purchasers of health care, and improve the quality and affordability of patient health care and health care coverage." *Liberty Mut. Ins. Co. v. Kimbell*, No. 2:11-CV-204, at *2 (D. Vt. Nov. 9, 2012) ([220 PBD, 11/15/12](#)).

In an effort to enforce the statute, Vermont subpoenaed claims data from Blue Cross Blue Shield of Massachusetts, Inc., which served as third party administrator for Liberty Mutual Insurance Co., a self-insured plan. Liberty Mutual instructed Blue Cross Blue Shield not to comply with the statute, however, because it was concerned that the reporting of claims data would be a breach of fiduciary duty under ERISA. Liberty Mutual subsequently filed suit against the State, seeking a declaration that ERISA preempted the Vermont reporting system and enjoining the State from enforcing it.

District Court and Second Circuit Opinions

The district court held that ERISA did not preempt the Vermont statute because, in its view, the statute "do[es] not act immediately and exclusively upon ERISA plans, nor is the existence of ERISA plans essential to [its] operation." *Id.* at *9. The Second Circuit reversed and held that ERISA preempted the Vermont statute because reporting and disclosure actions are core ERISA functions subject to a uniform federal standard, and Vermont's statute created the prospect that an employer's administrative scheme would be subject to conflicting and increasingly burdensome requirements. *Liberty Mut. Ins. Co. v. Donegan*, 746 F.3d 497, 508-09 (2d Cir. 2014) ([24 PBD, 2/5/14](#)).

U.S. Supreme Court Decision

The Supreme Court agreed to decide the question of "whether ERISA pre-empts the Vermont statute as it applies to ERISA plans." In a 6-2 decision authored by Justice Kennedy, the Court held that ERISA preempted the Vermont statute because the statute's reporting requirements overlapped with ERISA's reporting, disclosure, and recordkeeping requirements and frustrated ERISA's objective of uniformity by subjecting plans to novel and inconsistent reporting requirements. *Gobeille v. Liberty Mut. Ins. Co.*, 136 S. Ct. 936, 947 (2016) ([41 PBD, 3/2/16](#)).

The Court reviewed its prior precedent and explained that there are two ways in which a state law may be preempted under ERISA: (i) where a state law has a "reference to" ERISA plans; or (ii) where "a state law ... has an impermissible 'connection with' ERISA plans." A state law contains a "reference to" ERISA plans when "a State's law acts

immediately and exclusively upon ERISA plans ... or where the existence of ERISA plans is essential to the law's operation." It has a "connection with" ERISA plans where the law "governs ... a central matter of plan administration," "interferes with nationally uniform plan administration," or where " 'acute, albeit indirect, economic effects' of the state law 'force an ERISA plan to adopt a certain scheme of substantive coverage or effectively restrict its choice of insurers.' " In evaluating the scope of ERISA's preemption provision, the Court also has been guided by the ERISA's objectives and "the nature of the effect of the state law on ERISA plans."

Applying these principles, the Court observed that the Vermont statute's reporting requirements both intruded on "a central matter of plan administration"—reporting, disclosure, and recordkeeping requirements—and interfered with ERISA's objectives of national uniformity and cost efficiency. The Court explained that ERISA's current reporting, disclosure, and recordkeeping requirements are onerous, subjecting plans to civil and criminal liability for violations, and that the Secretary of Labor has the authority under the statute to promulgate and enforce additional requirements. Because reporting, disclosure, and recordkeeping activities are "central to, and an essential part of, the uniform system of plan administration contemplated by ERISA," the Court concluded preemption was necessary to prevent the imposition of "novel, inconsistent, and burdensome reporting requirements on plans." Thus, the state statute both infringed on one of ERISA's objectives and affected ERISA-plan administration.

In so ruling, the Court rejected Vermont's arguments against preemption. First, the Court determined that a plan need not wait until confronted with inconsistent obligations and ensuing costs before commencing suit. Second, the Court found irrelevant Vermont's argument that the statute's objectives differ from those of ERISA because the relevant inquiry is the nature of the effect of the state law on ERISA plans, and here the statute's reporting requirements affect a "fundamental ERISA function." Third, the Court rejected Vermont's argument that its actions were a proper exercise of the state's traditional powers "to regulate in the area of public health" because ERISA may preempt state regulations even if those regulations are an exercise of traditional state power.

Justices Thomas authored a concurrence in which he joined the Court's opinion based on its "faithful application of precedent," but expressed doubt about whether ERISA preemption, as it has been applied by the Court, "is a valid exercise of congressional power." Justice Thomas questioned whether any provision of the Constitution authorized Congress to prohibit states from applying a host of generally applicable civil laws to ERISA plans. In his view, "[j]ust because Congress can regulate some aspects of ERISA plans pursuant to the Commerce Clause does not mean that Congress can exempt ERISA plans from state regulations that have nothing to do with interstate commerce."

Justice Breyer also authored a concurring opinion agreeing with the majority that the Vermont statute was preempted by ERISA. He explained: "If each State is free to go its own way ... the result could well be unnecessary, duplicative, and conflicting reporting requirements, any of which can mean increased confusion and increased cost." Justice Breyer suggested that the Secretary of Labor promulgate reporting requirements and collect information, and the States could ask for it.

Justice Ginsburg, with whom Justice Sotomayor joined, dissented. Justice Ginsburg first reviewed whether Vermont's statute had an impermissible "connection with" ERISA plans

by looking to the "objectives of the ERISA statute as a guide." According to Justice Ginsburg, Vermont's statute and ERISA serve different purposes. On one hand, ERISA governs the design and administration of employee benefit plans, and its reporting requirements ensure that the plans in fact provide covered benefits. On the other hand, Vermont's data-collection statute aims to improve the quality and utilization, and reduce the cost, of health care in Vermont. According to Justice Ginsburg, "[b]ecause ERISA's reporting requirements and the Vermont law elicit different information and serve distinct purposes, there is no sensible reason to find the Vermont data-collection law preempted." Next, Justice Ginsburg reviewed the "nature of the effect of the state law on ERISA plans." She observed that the imposition of some burdens on ERISA plan administration has not sufficed to require preemption, and there was no "central matter of plan administration" touched by Vermont's statute. Lastly, Justice Ginsburg commented that declaring reporting a central or core ERISA function "passes the line this Court drew" in its earlier cases when it reined in ERISA's preemption provision "so that it would no longer operate as a 'super-preemption' provision."

Proskauer's Perspective

The Court's holding in *Gobeille* puts an end (at least for now) to all-payer claims databases that have been established by the States. This is good news for self-funded plan sponsors and fiduciaries who now need not be concerned about whether they will need to comply with burdensome and potentially conflicting state reporting requirements. Whether the Secretary of Labor implements Justice Breyer's suggestion that the Secretary promulgate reporting requirements and collect information for the States to request remains to be seen.

Sun Capital Court Finds Co-Investing Funds Part of Controlled Group and Liable for Portfolio Company's Pension Liabilities

By Ira G. Bogner, Colleen Hart and Justin Alex

As we previously [reported](#), in *Sun Capital*, the U.S. Court of Appeals for the First Circuit held in 2013 that a private investment fund, pursuant to the so-called "investment plus" test first articulated by the Pension Benefit Guaranty Corporation (the PBGC), was engaged in a "trade or business" under the Employee Retirement Income Security Act of 1974, as amended (ERISA) and could therefore be part of a "controlled group" with one of its portfolio companies and potentially liable for the portfolio company's underfunded pension liabilities. The *Sun Capital* case was remanded to the U.S. District Court of Massachusetts for further proceedings on whether a related private investment fund that invested in the portfolio company was also engaged in a "trade or business" and whether the two funds were under "common control" with the portfolio company. On March 28, 2016, the District Court determined that the second private investment fund was engaged in a "trade or business" and that the two funds' co-investment in the portfolio company constituted a "partnership-in-fact" (resulting in the aggregation of their ownership interests in the portfolio company) that was also engaged in a "trade or business." This determination resulted in both funds being treated as part of the portfolio company's "controlled group."

This decision could have far-reaching implications.

The District Court essentially substituted the statutory 80% ownership threshold for controlled group liability with a facts-and-circumstances analysis that could establish controlled groups among separate independent entities with ownership interests below 80% in a common subsidiary.

In addition, the District Court took an expansive view of what constitutes an "economic benefit" that will satisfy the "investment plus" test articulated by the First Circuit for whether a private investment fund is a "trade or business." In particular, the District Court found that management fee offsets could constitute an "economic benefit" even if the offsets are carried forward and potentially never used.

The PBGC and multiemployer pension plans may use this decision to further bolster their efforts to collect plan termination and withdrawal liability from private investment funds (and their other portfolio companies) that might be considered a part of a portfolio company's "controlled group." In addition, being a member of a "controlled group" may create other administrative issues, such as nondiscrimination testing on a controlled group basis for tax-qualified retirement plans and certain welfare plans. Controlled group members also have to consider the implications of being in a controlled group for purposes of the Consolidated Omnibus Budget Reconciliation Act of 1985, as amended (COBRA), health care reform and Section 409A of the Internal Revenue Code of 1986, as amended (Code), among other legal requirements. Pending future guidance from the government agencies (in particular, the Internal Revenue Service), the broader implications of this decision for employers and their employee benefit plans remains uncertain.

In short, private equity fund sponsors should be aware that (i) acquiring an 80% (or more) interest in a portfolio company, whether within one private equity fund or pursuant to a "joint venture" between related (and maybe even unrelated) funds, may trigger joint and several liability for the portfolio company's underfunded pension or withdrawal liabilities, and (ii) even a smaller ownership interest percentage could possibly trigger the ERISA "controlled group" rules based on complicated "common control" determinations.

For additional information about this case and its impact, please see our [client alert](#).

U.S. Department of Labor Finalizes Fiduciary Definition and Conflict of Interest Rule

On April 6, 2015, the U.S. Department of Labor (Department) issued its highly anticipated final rule addressing when a person is considered to be a fiduciary under the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code (Code) as a result of providing investment advice to a plan (including an individual retirement account (IRA)) or its participants or beneficiaries. As discussed below, the final rule (available [here](#)) offers a definition of fiduciary investment advice that expands the group of people who would be considered fiduciaries.

The Department also finalized a new Best Interest Contract Exemption (BICE) and amended other prohibited transaction class exemptions (PTCEs) applicable to fiduciaries that would allow certain broker-dealers, insurance agents and others who provide investment advice to continue to engage in certain transactions and to receive common forms of compensation that otherwise would be prohibited as conflicts of interest. The

BICE and amendments to the PTCEs will be addressed in separate forthcoming client alerts.

Background

ERISA provides that "a person is a fiduciary with respect to a plan to the extent . . . he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so." ERISA § 3(21)(A)(ii). Pursuant to a 1975 regulation, in order for a person to be held to ERISA's fiduciary standards with respect to investment advice for a fee, such person must: (i) make recommendations as to investing in, purchasing or selling securities or other property, or give advice as to their value, (ii) on a regular basis, (iii) pursuant to a mutual understanding that the advice, (iv) will serve as a primary basis for investment decisions with respect to plan assets, and (v) will be individualized to the particular needs of the plan.

The Department first published a new proposed rule on October 2010. In doing so, the Department stated its belief that the existing regulatory scheme no longer adequately protected plans, participants and beneficiaries. Facing immense pressure, on September 2011, the Department stated that the proposal would be withdrawn and that a new proposal would be issued at a later date.

In April 2015, the Department proposed a new set of rules on the belief that the new proposal was necessary to adequately protect plans, participants, beneficiaries, and, in particular, IRA owners (to which ERISA's current fiduciary rules regarding prudence and loyalty do not apply) from conflicts of interest, imprudence and disloyalty. The Department explained that under current law many investment professionals are not subject to ERISA's fiduciary standards and thus, in its view, have the ability to operate with undisclosed conflicts of interest. Addressing concerns raised over the past several years, the Department stated that it has consulted with other federal regulators, including the Securities Exchange Commission (SEC), concerning whether the proposal would subject investment professionals who provide investment advice to requirements that are overly burdensome or conflict with their obligations under other federal laws.

Since then, lobbyists on both sides of the issue have been voicing their concerns and views about the Department's proposal. The Department stated that it received over 3,000 comments and held four days of hearings (collectively, referred to herein as "comments"). Now, the final rule has been published and will apply as of April 10, 2017.

The Final Rule

The final rule first describes the kinds of communications or categories of advice that constitute "investment advice." It then describes the types of relationships and circumstances that give rise to fiduciary investment advice and thus subjecting the advice provider to fiduciary standards and certain prohibited transaction rules intended to address conflicts of interest and those types in which they do not. Below are summaries of these two parts of the final rule, along with observations on the differences between the final rule and the proposed rule.

(a) *Investment Advice*

The final rule describes the types of advice communications provided to a plan, plan fiduciary, plan participant or beneficiary, IRA, or IRA owner, which, when provided for a fee or other compensation, directly or indirectly, and given under certain circumstances (discussed below), would be "investment advice."

(1)(i) *Investment Recommendations.* *"A recommendation as to the advisability of acquiring, holding, disposing of, or exchanging, securities or other investment property or a recommendation as to how securities or other investment property should be invested after the securities or other investment property are rolled over, transferred, or distributed from the plan or IRA."*

The Department modified the proposal rule to make it clear that the adviser must make a recommendation with respect to the advisability of acquiring, holding, disposing or exchanging securities or other investment property to fall within this section of the rule. Accordingly, recommendations to purchase group health, disability, term life or similar insurance policies that do not have an investment component are not covered. The final rule creates an important distinction between investment advice and investment education (discussed below).

(1)(ii) *Investment Management Recommendations.* *"A recommendation as to the management of securities or other investment property, including, among other things, recommendations on investment policies or strategies, portfolio composition, selection of other persons to provide investment advice or investment management services; selection of investment account arrangements (e.g., brokerage versus advisory); or recommendations with respect to rollovers, transfers, or distributions from a plan or IRA, including whether, in what amount, in what form, and to what destination such a rollover, transfer or distribution should be made."*

In response to comments that the term "management" should be clarified, the final rule adds examples (stated in the italicized text above) to clarify the scope of the definition. The revisions also are intended to make clear that advice providers cannot avoid fiduciary responsibility for recommendations to roll over plan or IRA assets (e.g., to a mutual fund provider) by not including in that recommendation any advice on how to invest the assets after they are rolled over. To that end, the final rule supersedes the Department's position in Advisory Opinion 2005-23A (Dec. 7, 2005).

In addition, this provision was amended to include recommendations regarding the "selection of other persons to provide investment advice or investment management services," which was contained in a separate provision in the proposed rule. This was done to better reflect that recommendations of persons to perform investment management services for plans or IRAs are examples of recommendations on investment management.

The Department also provided its view on a number of comments to the proposed rule in the summary of the final rule:

- A special rule for sales and marketing of proprietary products was unnecessary.

- The fact that an organization is exempt from tax under the Code or that it has an educational or charitable mission does not provide a basis for excluding investment advice provided to plan or IRA investors by those organizations from fiduciary regulation.
- Actuaries, accountants, and attorneys – who historically have not been treated as ERISA fiduciaries for plan clients – would not become fiduciaries investment advisers by reason of providing actuarial, accounting, or legal services.
- The final rule does not alter ERISA Interpretive Bulletin 75-8, D-2 at 29 C.F.R. § 2509.75-8 (1975), which explains that a plan sponsor's human resources personnel or plan service providers who have no power to make decisions as to plan policy, interpretations, practices, or procedures, but who perform purely administrative functions for an employee benefit plan, within a framework of policies, interpretations, rules, practices and procedures made by other persons, are not thereby investment fiduciaries with respect to the plan.
- ERISA § 404(c) would not provide any relief from liability for a fiduciary investment adviser for investment advice provided to a participant or beneficiary.
- Merely advising a participant or IRA owner that certain minimum distributions are required by tax law would not constitute investment advice.
- The Department did not believe special clarification was needed with respect to foreign exchange transactions, the internal operation of stable value funds, and options trading. The Department noted that recommendations on foreign exchange transactions and options trading clearly can involve recommendations on investment policies or strategies and portfolio composition.
- A person or firm can tout the quality of his, her or its advisory or investment management services and recommend that a plan or IRA investor enter into an advisory relationship with the adviser without triggering fiduciary obligations. However, when a recommendation to "hire me" effectively includes a recommendation on how to invest or manage plan or IRA assets (*e.g.*, whether to roll assets into an IRA or plan or how to invest assets if rolled over), that recommendation could trigger fiduciary obligations.
- The final rule does not carry forward a provision in the proposed rule covering appraisals and valuations as investment advice and appraisals and valuations will instead be addressed in a separate project.

Fee or Other Compensation

Fiduciary status under ERISA requires that the investment advice be provided for a "fee or other compensation, direct or indirect." The final rule defines this phrase to mean *"any explicit fee or compensation for the advice received by the person (or by an affiliate) from any source, and any other fee or compensation received from any source in connection with or as a result of the purchase or sale of a security or the provision of investment advice services, including though not limited to, commissions, loads, finder's fees, revenue sharing payments, shareholder servicing fees, marketing or distribution fees, underwriting compensation, payments to brokerage firms in return for shelf space, recruitment compensation paid in connection with transfers of accounts to a registered representative's new broker-dealer firm, gifts and gratuities, and expense reimbursements. A fee or compensation is paid 'in connection with or as a result of' such transaction or service if the fee or compensation would not have been paid but for the transaction or service or if eligibility for or the amount of the fee or compensation is based in whole or in part on the transaction or service."*

(a)(2) The Circumstances under Which Advice Is Provided

A person would be considered a fiduciary investment adviser in connection with a recommendation, if the recommendation is made either directly or indirectly (e.g., through or together with any affiliate) by a person who:

- i Represents or acknowledges that he or she is acting as a fiduciary within the meaning of ERISA or the Code with respect to the advice described in Section (a)(1);
- ii Renders the advice pursuant to a written or verbal agreement, arrangement, or understanding that the advice is based on the particular investment needs of the advice recipient; or
- iii Directs the advice to a specific advice recipient or recipients regarding the advisability of a particular investment or management decision with respect to securities or other investment property of the plan or IRA.

Advisers who claim fiduciary status may not later argue that their advice was not fiduciary in nature. The final rule does not require a meeting of the minds as to the extent to which the recipient will actually rely on the advice, but the parties must agree or understand that the advice is individualized or specifically directed to the particular advice recipient for consideration in making investment decisions. There is no requirement that the advice be specific to the needs of the plan, participant or beneficiary or IRA owner; rather, the advice only needs to be specifically directed to such recipient. There is no requirement that the advice be provided on a regular basis.

(b) Definition of Recommendation

In response to comments expressing concern or confusion regarding several of the "carve-outs" from the definition of recommendation identified in the proposed rule, the Department determined that the carve-out approach was not the best way – structurally or definitionally – to delineate the scope of investment advice. Instead, the final rule uses an alternative approach (discussed below) for describing the scope of what constitutes a "recommendation."

The final rule clarifies and reclassifies the "carve-outs" in the proposed rule as either (i) examples of communications and activities that are not recommendations (and thus

not fiduciary investment advice), or (ii) communications that might constitute recommendations but nevertheless do not constitute fiduciary investment advice.

(b)(1) Communications and Activities That Constitute "Recommendations"

A "recommendation" means "a communication that, based on its content, context, and presentation, would reasonably be viewed as a suggestion that the advice recipient engage in or refrain from taking a particular course of action. The determination of whether a 'recommendation' has been made is an objective, rather than subjective inquiry. In addition, the more individually tailored the communication is to a specific advice recipient or recipients about, for example, a security, investment property, or investment strategy, the more likely the communication will be viewed as a recommendation. Providing a selective list of securities to a particular advice recipient as appropriate for that investor would be a recommendation as to the advisability of acquiring securities even if no recommendation is made with respect to any one security. Furthermore, a series of actions, directly or indirectly (e.g., through or together with any affiliate), that may not constitute a recommendation when viewed individually may amount to a recommendation when considered in the aggregate. It also makes no difference whether the communication was initiated by a person or a computer software program."

(b)(2) Communications and Activities That Do Not Constitute "Recommendations"

i Platform Providers

This provision is intended to cover service providers, such as record-keepers and third-party administrators, that offer a "platform" or selection of investment vehicles to participant-directed individual account ERISA plans, but not to plan participants and beneficiaries, and IRAs. The final rule makes clear that persons would not be providing investment advice by marketing or making available to a plan specific investment alternatives to be made available to participants, without regard to the individualized needs of the plan or its participants and beneficiaries, as long as the plan fiduciary is independent of the person who markets or makes available the investment alternatives and the platform provider discloses in writing that it is not undertaking to provide impartial investment advice or to give advice in a fiduciary capacity.

ii Selection and Monitoring Assistance

The final rule provides that certain common activities that platform providers may carry out to assist plan fiduciaries in selecting and monitoring investment alternatives that they offer to participants are not recommendations, such as (a) identifying investment alternatives meeting objective criteria specified by the plan fiduciary (e.g., expense ratios, fund size, or asset type or credit quality), (b) in response to a request, identifying a limited or sample set of investment alternatives based on only the size of the plan or employer, the current designated investment alternatives, or both, or (c) providing objective financial data regarding available alternatives to the plan fiduciary. With respect to the first two examples, the person identifying the investment alternatives must disclose in writing whether the person has a financial interest in any of the identified investment alternatives and, if so, the precise nature of that interest.

iii General Communications

A recommendation does not include the furnishing of "general communications" that a reasonable person would not view as an investment recommendation, including general circulation newsletters, television, radio, and public media talk show commentary, and remarks in widely attended speeches and conferences; research reports prepared for general distribution, general marketing materials, general market data, including data on market performance, market indices, or trading volumes, price quotes, performance reports, or prospectuses.

iv Investment Education

Furnishing or making available educational information and materials to a plan, plan fiduciary, participant, beneficiary or IRA owner will not constitute the provision of investment advice, regardless of who provides the information (e.g., plan sponsor, fiduciary or service provider), the frequency with which the information is shared, the form in which it is provided (e.g., on an individual or group basis, in writing or orally, via a call center, or by way of video or computer software), and whether an identified category of information and materials is provided or made available alone or in combination with other categories identified, or the type of plan or IRA involved.

The final rule incorporated much of Interpretive Bulletin 96-1 (IB 96-1). The categories of investment education information and materials include, but are not limited, to certain: (a) plan information that, for example, describes the terms or operation of a plan or IRA; (b) general financial, investment and retirement information (such as effects of inflation and historic differences in rates of return between different asset classes); (c) asset allocation models; and (d) interactive investment materials (that, for example, provide a means to estimate future retirement income).

In response to comments to the proposed rule, the Department made several adjustments and the final rule provides that asset allocation models and interactive investment materials can identify a specific investment product or specific alternative available under plans and be considered education (and not a fiduciary investment recommendation) if: (1) the alternative is a designated investment alternative under an employee benefit plan; (2) the alternative is subject to fiduciary oversight by a plan fiduciary independent of the person who developed or markets the investment alternative or distribution option; (3) the asset allocation models and interactive investment materials identify all the other designated investment alternatives available under the plan that have similar risk and return characteristics, if any; and (4) the asset allocation models and interactive investment materials are accompanied by a statement that identifies where information on those investment alternatives may be obtained. The final rule does not, however, deem such communications "education" and not fiduciary investment recommendations when made to IRA owners.

(c) Persons Not Deemed Investment Advice Fiduciaries

The final rule provides that certain communications and activities shall not be deemed to be fiduciary investment advice, including counterparty transactions, swap transactions, and certain employee communications.

1. Transactions with Independent Plan Fiduciaries with Financial Expertise

Fiduciary status does not attach to advice and recommendations made to an expert plan fiduciary (including a fiduciary of an entity that holds plan assets) in an arm's-length sale, purchase, loan, exchange, or other transaction related to the investment of securities or other property where there is generally no expectation of fiduciary investment advice, provided several conditions are satisfied. A person shall not be deemed to be a fiduciary solely because of the provision of any advice to an independent fiduciary of a plan or IRA with respect to an arm's length sale, purchase, loan, exchange, or other transaction involving the investment of securities or other property, if, prior to entering the transaction the person providing the advice satisfies the following requirements:

- i The person knows or reasonably believes that the independent fiduciary of the plan or IRA is: (A) certain regulated and supervised banks; (B) an insurance carrier which is qualified under the laws of more than one state to perform the services of managing, acquiring or disposing of assets of a plan; (C) a registered investment adviser; (D) a registered broker-dealer; or (E) any other person acting as an independent fiduciary that holds, or has under management or control, total assets of at least \$50 million. The person may rely on written representations from the plan or independent fiduciary to satisfy this condition.

The \$50 million threshold is a change from the proposed rule, which would have required \$100 million in assets for the exclusion to apply. The final rule reflects the Department's desire to ensure that it appropriately distinguishes between incidental advice as part of an arm's-length transaction, with no expectation of trust or acting in the customer's best interest, from those instances where a customer may be expecting unbiased investment advice that is in its best interest.

- ii The person knows or reasonably believes that the independent fiduciary of the plan or IRA is capable of evaluating investment risks independently, both in general and with regard to particular transactions and investment strategies. The person may rely on written representations from the plan or independent fiduciary to satisfy this condition.
- iii The person fairly informs the independent plan fiduciary that the person is not undertaking to provide impartial investment advice, or to give advice in a fiduciary capacity, in connection with the transaction and must fairly inform the independent plan fiduciary of the existence and nature of the person's financial interests in the transaction.
- iv The person knows or reasonably believes that the independent fiduciary is a fiduciary under ERISA or the Code, or both, with respect to the transaction and is responsible for exercising independent judgment in evaluating the transaction. The person may rely on written representations from the plan or independent fiduciary to satisfy this requirement.

- v The person does not receive a fee or other compensation directly from the plan, plan fiduciary, plan participant or beneficiary, IRA or IRA owner for the provision of investment advice (as opposed to other services) in connection with the transaction.

The counterparty exclusion does not apply to recommendations to retail investors, including small plan fiduciaries, IRA owners and plan participants and beneficiaries. The Department believes that recommendations to retail investors and small plan providers generally are not "arm's-length" and are presented routinely as advice, consulting, or financial planning services.

(2) Swap and Security-Based Swap Transactions

Persons acting as swap dealers, security-based swap dealers, major swap participants, and major security-based swap participants do not become investment advice fiduciaries as a result of communications and activities conducted during the course of swap or security-based swap transactions regulated under the Dodd-Frank Act provisions in the Commodity Exchange Act or the Securities Exchange Act of 1934 and applicable CFTC and SEC implementing rules and regulations if certain conditions are met. The following conditions must be satisfied for this provision to apply:

- i In the case of a swap dealer or security based swap dealer, the person is not acting as an adviser to the plan (within the meaning of Section 4s(h) of the Commodity Exchange Act or Section 15f(h) of the Securities Exchange Act of 1934) in connection with the transaction;
- ii The employee benefit plan must be represented in the transaction by an ERISA fiduciary independent of the person;
- iii The person does not receive a fee or other compensation directly from the plan or plan fiduciary for the provision of investment advice (as opposed to other services) in connection with the transaction; and
- iv In advance of providing any recommendations with respect to the transaction, the person obtains a written representation from the independent plan fiduciary that the independent fiduciary understands that the person is not undertaking to provide impartial investment advice, or to give advice in a fiduciary capacity, in connection with the transaction and that the independent plan fiduciary is exercising independent judgment in evaluating the recommendation.

(3) Employees

A person is not an investment advice fiduciary if, in his or her capacity as an employee of a plan sponsor of an ERISA plan, employees of an affiliate of such plan sponsor, employees of an employee benefit plan, employees of an employee organization, and employees of a plan fiduciary, the person provides advice to a plan fiduciary or to an employee (other than in his or her capacity as a participant or beneficiary of a plan) or to an independent contractor of a plan sponsor, affiliate and plan, provided the person receives no fee other compensation, direct or indirect, in connection with the advice beyond their normal compensation for work performed for the employer.

This rule protects internal employees, such as human resources professionals, who routinely may develop reports and recommendations for investment committees and other named fiduciaries of sponsors' plans. The final rule was revised from the proposed

rule to clarify that it covers employees even if they are not the persons ultimately communicating directly with the plan fiduciary (e.g., employees in financial departments that prepare reports for the CFO who then communicates directly with a named fiduciary of the plan).

Similarly, the exclusion also covers communications between employees (e.g., human resources department staff) communicating information to other employees about the plan and distribution options in the plan subject to certain conditions. Specifically, the exclusion covers circumstances where an employee of the plan sponsor of a plan, or as an employee of an affiliate of such plan sponsor, provides advice to another employee of the plan sponsor in his or her capacity as a participant or beneficiary of the plan, provided the person's job responsibilities do not involve the provision of investment advice or investment recommendations, the person is not registered or licensed under federal or state securities or insurance laws, the advice they provide does not require the person to be registered or licensed under federal or state securities or insurance laws, and the person receives no fee or other compensation, direct or indirect, in connection with the advice beyond the employee's normal compensation for work performed for the employer.

(d) Scope of Fiduciary Duty – Investment Advice

A person who is a fiduciary with respect to a plan or IRA by reason of rendering investment advice for a fee or other compensation, direct or indirect, with respect to any securities or other investment property of such plan or IRA, or having any authority or responsibility to do so, shall not be deemed to be a fiduciary regarding any assets of the plan or IRA with respect to which such person does not have such authority, control or responsibility. However, the absence of such authority, control or responsibility does not exempt such person from the provisions of Section 405(a) of ERISA, or exclude such persons from the definition of the term "party in interest" under ERISA or "disqualified person" under the Code with respect to any assets of the employee benefit plan or IRA.

(e) Execution of Securities Transactions

(1) A person who is a broker or dealer registered under the Exchange Act, a reporting dealer who makes primary markets in securities of the United States Government or of an agency of the United States Government and reports daily to the Federal Reserve Bank of New York its positions with respect to such securities and borrowings thereon, or a bank supervised by the United States or a State, shall not be deemed to be a fiduciary with respect to a plan or IRA solely because such person executes transactions for the purchase or sale of securities on behalf of such plan in the ordinary course of its business as a broker, dealer, or bank, pursuant to instructions of a fiduciary with respect to such plan or IRA, if:

- i Neither the fiduciary nor any affiliate of such fiduciary is such broker, dealer, or bank; and
- ii The instructions specify:
 - (A) The security to be purchased or sold;
 - (B) A price range within which such security is to be purchased or sold, or, if such security is issued by an open-end investment company registered under the Investment Company Act of 1940, a price which is determined in accordance with Rule 22c1 under the Investment Company Act of 1940;

(C) A time span during which such security may be purchased or sold (not to exceed five business days); and

(D) The minimum or maximum quantity of such security which may be purchased or sold within such price range, or, in the case of a security issued by an open-end investment company registered under the Investment Company Act of 1940, the minimum or maximum quantity of such security which may be purchased or sold, or the value of such security in dollar amount which may be purchased or sold, at the price referred to above.

(2) A person who is a broker-dealer, reporting dealer, or bank which is a fiduciary with respect to a plan or IRA solely by reason of the possession or exercise of discretionary authority or discretionary control in the management of the plan or IRA, or the management or disposition of plan or IRA assets in connection with the execution of a transaction or transactions for the purchase or sale of securities on behalf of such plan or IRA which fails to comply with the provisions of paragraph (e)(1) of this section, shall not be deemed to be a fiduciary regarding any assets of the plan or IRA with respect to which such broker-dealer, reporting dealer or bank does not have or exercise any discretionary authority, discretionary control or discretionary responsibility, does not render investment advice for a fee or other compensation, and does not have any authority or responsibility to render such investment advice. However, the absence of such authority, control or responsibility does not exempt such person from the provisions of Section 405(a) of ERISA, or exclude such persons from the definition of the term "party in interest" under ERISA or "disqualified person" under the Code with respect to any assets of the employee benefit plan or IRA.

Applicability Date

The final rule applies April 10, 2017.

Rulings, Filings, and Settlements of Interest

District Court Applies Dudenhoeffer "More Harm Than Good" Standard to Closely-Held Corporation

By Madeline Chimento Rea

A federal district court in Mississippi ruled for the first time that the "more harm than good" pleading standard established by the Supreme Court in *Fifth Third Bancorp v. Dudenhoeffer*, 134 S. Ct. 2459 (2014), applied to employer "stock drop" claims brought against the fiduciaries of plans sponsored by closely-held corporations. Hill Brothers Construction Company, Inc. ("Hill Brothers"), a closely-held corporation, ceased operations and subsequently sent notice to all 401(k) plan (the "Plan") participants that their retirement accounts were worthless. Plaintiffs, former employees of Hill Brothers, commenced a putative class action on behalf of all current and former participants and beneficiaries of the Plan alleging that the Plan fiduciaries breached their fiduciary duties to manage the Plan's assets prudently and loyally and to monitor other fiduciaries adequately. In *Dudenhoeffer*, the Supreme Court held, in a case involving a publicly traded employer stock fund, that in order to state a claim for breach of fiduciary duty on the basis of inside information, a plaintiff must plausibly allege (among other things) an alternative action that could have been taken by the plan fiduciaries that would have been consistent with its obligations under securities laws and that a prudent fiduciary would not

have viewed as more likely to harm the fund than to help it. The district court agreed that this standard applied to the allegations against the closely held corporation and dismissed the complaint upon finding that plaintiffs had failed to plead such an alternative course of action. The case is *Hill v. Hill Brothers Construction Company*, No. 14-213, 2016 WL 1252983 (N.D. Miss. Mar. 28, 2016).

District Court Rules Johnson Controls Retirees Not Entitled to Lifetime Health Benefits

By Madeline Chimento Rea

A district court in the Middle District of Pennsylvania held that, notwithstanding the Supreme Court's decision in *M & G Polymers USA, LLC v. Tackett*, 135 S. Ct. 926 (2015), the Third Circuit's rule that clear and express language was required for health benefits to vest was still good law. On that basis, it ruled that Johnson Controls, an employer, was not required by the applicable collective bargaining agreements ("CBAs") to provide lifetime health benefits to its unionized retirees. Every few years, the UAW negotiated a new CBA with Johnson Controls or its predecessors providing health insurance benefits for employees and former employees. In 2009, Johnson Controls implemented a \$50,000 lifetime cap on benefits for participants sixty-five and older, which resulted in some members being ineligible for future benefits. Plaintiffs, retirees who exceeded the lifetime cap, filed suit on behalf of themselves and similarly-situated groups of retirees. In plaintiffs' view, the *Tackett* decision, including Justice Ginsburg's concurrence in which she stated that clear and express language was not required to create vested rights to retirement benefits, prohibited presumptions for or against vesting. The district court ruled that *Tackett* had no effect on the Third Circuit's "clear and express" standard, and that the rule is consistent with *Tackett's* instruction to apply ordinary principles of contract law. Applying the Third Circuit rule, the court then divided the CBAs into three groups. For the first group, the court held that the inclusion of the phrase "shall have the following benefits . . . continued" did not unambiguously indicate that the benefits would vest past the expiration date of the applicable CBA. For the second group, the court held that the statement that health coverage would be continued "until your death," was not a promise to vest unalterable health benefits in light of the explicit durational clauses and other language in the CBAs indicating that the parties intended that the health benefits would terminate. Instead, "until your death" indicated that the retirees were entitled to benefits during the term of the CBA but the benefits terminated if a retiree died before the CBA's expiration. And, for the final group, there was a clear and unambiguous reservation of rights. The court thus granted defendants' motion for summary judgment, finding that none of the applicable agreements created vested rights to retirement benefits. The case is *Grove v. Johnson Controls, Inc.*, No. 12-2622, 2016 WL 1271328 (M.D. Pa. Mar. 31, 2016).

Court Enforces Forum Selection Clause in ERISA Plan

By Benjamin Saper

A federal district court in New York enforced an ERISA retirement plan's forum selection clause and transferred the case to the District of New Jersey. The plaintiff argued that the forum selection clause was invalid because it conflicted with ERISA's venue provision, which provides that an ERISA action "may be brought in the district where the plan is administered, where the breach took place, or where a defendant resides or may be

found." ERISA Section 502(e). The court held that ERISA's venue rule provides a set of options, but does not prohibit private parties from narrowing the options to one of the three enumerated venues through a forum selection clause (and deferred for another day whether a venue selection clause could specify a venue unrelated to ERISA Section 502(e)). The court noted that its holding was in line with the vast majority of courts to consider the issue. The case is *Malagoli v. AXA Equitable Life Ins. Co.*, No. 14-CV-7180 (AJN), 2016 BL 92517 (S.D.N.Y. Mar. 24, 2016).

U.S. DOL to Issue Final Rule and Exemptions on Fiduciary Standards

By Russell Hirschhorn, Robert Projansky, Ira G. Bogner and David Picon

Today, the U.S. Department of Labor will release its highly-anticipated Final Rule and Exemptions addressing when a person providing investment advice with respect to an employee benefit plan or individual retirement account is considered to be a "fiduciary" under the Employee Retirement Income Security Act of 1974 and the Internal Revenue Code. According to a Fact Sheet released in advance of the new rule's publication, the "DOL has streamlined and simplified the rule to minimize the compliance burden and ensure ongoing access to advice, while maintaining an enforceable best interest standard that protects savers." According to the Fact Sheet:

- The rule requires more retirement investment advisers to put their client's best interest first, by expanding the types of retirement advice covered by fiduciary protections
- The rule clarifies what does and does not constitute fiduciary advice
- The exemptions will allow firms to accept common types of compensation – like commissions and revenue sharing payments – if they commit to putting their client's best interest first
- The rule and exemptions ensure that advisers are held accountable to their clients if they provide advice that is not in their clients' best interest

The Fact Sheet also reports that that the Final Rule and Exemptions contain significant changes based on the feedback received during the comment period:

- Further clarifying what constitutes fiduciary advice
- Making best interest contract (BIC) exemption available for more advice
- Streamlining and simplifying requirements of BIC exemption
- Grandfathering existing investments
- Extending implementation time period

This post is the first in a series that we will publish about key aspects of the Final Rule and Exemptions. Please stay tuned for further developments and analyses.

A copy of the Fact Sheet is available at <http://src.bna.com/dUb>.

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

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