KRUCHKO & FRIES

Management Labor, Employment & Benefits News

eNewsletter

Spring 2007

Employment Law Happenings: Nuances that Could Affect Your Business

*By: John G. Kruchko, Esq. and Kevin B. McCoy, Esq.**

Everybody knows that you cannot fire someone because of immutable characteristics, such as race, gender, or nationality. Everybody knows that you have to be paid at least the "minimum wage" and may be eligible for overtime. And everybody knows that federal law allows new mothers (and their husbands) to take twelve (12) weeks of "family and medical leave." However, those basic, general truths do not go very far when faced with implementing them in everyday situations that can be as diverse as they are similar. As is often the case with life, the "devil is in the details." When it comes to employment matters, knowing more than just the "headlines" can greatly enhance your company's ability to deal effectively, efficiently, and legally with the myriad of situations that arise on a daily basis.

A. Call-in Procedures and FMLA Compliance

The Family and Medical Leave Act ("FMLA") is forever the source of considerable angst for employers trying to designate and

In this issue…

Employment Law Happenings 1
Upcoming Events and Announcements 1
Supervisory Status Under The National Labor Relations Act 4
California Alert 6
IRS Announces COLA Adjustments to Benefit Plan Limitations for 2007 7
Pension Protection Act of 2006 8
Attorneys In The News 13

Upcoming Events/Announcements

The **Labor & Employment Law Breakfast Series – 2007**, sponsored by **Kruchko & Fries** and WTPF – The Business Forum for HR Professionals, will be held from 8:30 – 10:00 a.m. on the following dates at the Tower Club, McLean, VA. Register at www.kruchkoandfries.com/inthenews. Topics include:

April 18, 2007 – "The HR Nightmare: Immigration and Security Challenges Facing Employers" – presented by **Kathleen A. Talty** and **Kevin B. McCoy**

May 23, 2007 – "Avoiding Compensation and Benefits Litigation: What You Don't Know (and Your Employees May) Can Hurt You" – presented by **Keith S. Fischler**

1750 Tysons Boulevard * Suite 560 * McLean, VA 22102 * (703) 734-0554 * Fax (703) 734-0876
502 Washington Avenue * Suite 400 * Baltimore, MD 21204 * (410) 321-7310
601 Pennsylvania Avenue, N.W. * Suite 900 * Washington, DC 20004 * (202) 347-6550
www.kruchkoandfries.com

Copyright 2007 Kruchko & Fries. All rights reserved. Kruchko & Fries Management Labor, Employment & Benefits News is published as a general information source for our clients and colleagues. Articles are general in nature and are not intended to constitute legal advice or opinion in a particular case. The reader must consult with legal counsel to determine how laws or decisions discussed herein apply to the reader's specific circumstances. We welcome your comments and questions.

calculate medical and/or family leave for employees who choose to use time on an emergency or intermittent basis instead of in one lump sum. Typically, employees who seek to use FMLA leave must give their employer thirty (30) days notice. However, in emergency situations, an employee must only give notice "as soon as practicable." That phrase has typically been interpreted to mean one or two business days in advance of the leave. Yet, what happens when an employee gets sick or has a family emergency the night before work or, worse yet, in the morning on the way to work?

The FMLA allows employers to craft "call-in" policies for short-notice absences so that the employer has as much notice as possible when an employee is going to be absent from work. Indeed attendant FMLA regulations provide that an employer may require compliance with its "usual and customary" notice requirements for leave. A conflict arises, however, when an otherwise evenhanded "call-in" policy becomes legitimately problematic in a particular situation.

A federal district court in Alabama recently considered the impact of an employer's "call-in" policy that provided the absence would only be excused if the employee called his supervisor at least one hour prior to the start of his shift (*Spraggins v. Knauf Fiber Glass GMBH*). The employee followed the procedure for several days while caring for his pregnant wife who was beset by complications. On the morning the employee prepared to return to work, his wife again became ill, and the employee failed to call in an hour before his shift started. When the employee finally reported to work, the company fired him for not adhering to the "call-in" policy.

At the summary judgment stage of the proceedings, the employer argued that the employee simply failed to comply with its "usual and customary" policy for "call-ins" and it was, therefore, justified in terminating his employment. The Court disagreed, noting that while the employer's "call-in" policy requiring one-hour notice was facially valid under the FMLA, requiring a specific employee to give an hour's notice when it was unclear whether he could have reasonably given such advance notice was an unreasonable application of the policy and, thus, a potential violation of the FMLA's notice requirements.

The lesson to be learned for employers is two-fold: (1) do not scrap your "call-in" policies; reasonable policies are valid and may generally be enforced by employers without running afoul of the FMLA; but (2) you must apply such policies in a flexible fashion to every factual situation to determine whether compliance with the notice requirements would be unreasonable.

B. Prorating Bonuses Following FMLA Leave

The proration of "bonus" due an employee who was absent for a portion of the fiscal year due to FMLA protected leave has been a subject of much conjecture among legal pundits and a source of much concern for employers. Thankfully, the United States Court of Appeals for the Third Circuit recently issued an opinion that offers significant clarification on how employers may legally calculate bonus payments to those employees who have been absent due to FMLA leave (*Sommer v. Vanguard Group*). The decision represents the federal appellate courts' first pronouncement on the legality of prorating bonus payments under the FMLA.

Fortunately for employers, the news is good. The Department of Labor has historically divided bonus payments into two categories: (1) "absence of occurrence bonuses," and (2) "production bonuses." An "absence of occurrence bonus" tends to reward an employee for compliance with company rules – such as, for example, bonus payments for a fiscal year completed without any OSHA violations. On the other hand, a "production bonus" requires the individual employee to take some positive effort or achieve a certain goal before

getting the bonus – such as achieving a certain number of hours worked or sales completed. The Court of Appeals concluded that FMLA leave should not affect an "absence of occurrence" bonus because the employee's leave did not adversely affect the basis on which the bonus was calculated. By contrast, the Court concluded a "production bonus" may very well be affected by the employee's leave because it directly affects the employee's ability to achieve the positive goal that triggers the bonus. The Court thus concluded that employers may prorate "production bonuses" to employees who were absent due to FMLA leave, but may not prorate "absence of occurrence bonuses" to its employees.

Light bulbs and sirens should now be flashing! Employers can avoid having to pay their FMLA leave employees all of a bonus they might have been otherwise entitled to receive but for the leave, so long as the bonus program can be fairly interpreted to be a "production bonus" program. The Court's decision essentially underscores the importance for employers to carefully craft their bonus programs to ensure they are "production bonus" based and not based on merely an "absence of occurrence." The best way to accomplish this feat is to clearly and plainly identify the goals and benchmarks that must be met in order to receive bonus payments, and to carefully define those benchmarks in terms of positive goals or accomplishments that the employee must meet or exceed. Since creating such a program is not easy or routine, employers should definitely enlist the assistance of their employment counsel to assist in the drafting and implementation of the program.

C. Minimum Wages, Living Wages, and the Employers' Obligations

With a newly elected Democratic Congress, it will come as a surprise to no one that increasing the federal minimum wage – stuck at $5.15 for the past decade -- may become a significant priority. While many business owners grumble and groan over the prospects of the feds raising the minimum wage, they tend to overlook the wage requirements that their states and even cities are starting to impose. Surprisingly, many employers do not realize that the federal minimum wage is not the "hard and fast" standard; it simply represents the floor beneath which employers may not proceed. States and cities are free to impose higher wages than the federal government, and many have done just that. To be exact, twenty-two (22) states now have minimum wages higher than the federal minimum wage – including Maryland and the District of Columbia. Virginia's minimum wage is currently the same as the federal minimum wage. Of course, states vary on their minimum wage rates. That puts an increased burden on multi-state employers to keep track of the various requirements and pay their employees accordingly. Even if the new Congress raises the minimum wage, that will not alleviate employers' burdens to be mindful of state and local requirements because some jurisdictions, like the District of Columbia, have provisions that automatically set the minimum wage higher than the federal minimum wage – no matter what the dollar amount.

Perhaps more disconcerting to employers is the so-called "living wage," which is defined by its proponents as the wage a full-time employee would need to earn to support a spouse and two children above the federal poverty threshold. Based on that definition, it is not surprising that "living wages" tend to substantially exceed state and federal minimum wage requirements, typically ranging from $9 to $10 per hour. And many such laws incorporate provisions regarding health benefits and hiring practices. At present, more than seventy (70) jurisdictions (both state and local) have enacted some type of "living wage" statute. Fortunately, many of the current laws (but not all) apply to a limited class of employees, such as government contractors, those businesses that receive public subsidies, and some not for profit organizations. However, there is

no guarantee that the trend will continue – particularly if the federal government continues to delay in raising the federal minimum wage.

Chicago recently enacted its "big box" living wage ordinance – aptly named because it applies to very large retailers. Other cities like New Orleans, Santa Fe, Albuquerque, and San Francisco have adopted living wages that apply to a broader class of employees. Closer to home, the Council for the District of Columbia has introduced the "Large Retailer Accountability Act." The proposed law would apply to large retailers with indoor premises of 30,000 square feet or more, and that has a parent company that grosses more than $1billion per year. The proposal also applies to the large retailers' subcontractors – regardless of the size of the subcontractor. The Council is expected to vote on the measure before the end of the year.

There is no question that the onslaught of higher state and local minimum wages and "living wages" is due to the stagnant minimum wage. Indeed, the current stretch is the longest period without a minimum wage hike since the minimum wage was introduced almost seventy (70) years ago. Regardless of whether the minimum wage is increased, however, there will still remain jurisdictions that offer a higher wage. Employers must be vigilant to not only keep up with the federal minimum wage, but to keep up with the state and local requirements imposed by those localities where they do business. Getting caught paying employees less than the "minimum wage" – whatever dollar figure that happens to be – can be a costly legal mistake.

Supervisory Status Under The National Labor Relations Act

By: Paul M. Lusky

In September, 2006, the National Labor Relations Board (the "Board") attempted to clarify its test for determining whether an individual is a supervisor under the National Labor Relations Act. In *Oakwood Healthcare, Inc.*, 348 NLRB No. 37 (Sept. 29, 2006), the Board held that certain "permanent" charge nurses employed by an acute care hospital exercised supervisory authority in assigning employees within the meaning of Section 2(11) of the National Labor Relations Act (the "Act").

Section 2(11) of the Act specifically excludes supervisors from the definition of "employee" under the Act. As a result, supervisors cannot be included in bargaining units with employees protected by the Act. A statutory "supervisor" is:

> any individual having the authority, in the interest of the employer, to hire, transfer, suspend, lay off, recall, promote, discharge, assign, reward, or discipline other employees, or responsibly to direct them, or to adjust their grievances, or effectively to recommend such action, if in connection with the foregoing the exercise of such authority is not of a merely routine or clerical nature, but requires the use of independent judgment.

The Board in *Oakwood Healthcare* examined whether the hospital's charge nurses were statutory supervisors based on the charge nurses' role in assigning nursing personnel to patients and directing the nursing staff in the performance of their duties. The Board majority found that Oakwood's permanent charge nurses were Section 2(11) supervisors because they had the authority to "assign" and exercised independent judgment in making these assignments in the interest of their employer. In making this finding, the Board

majority adopted the following definitions for the terms "assign," "responsibly to direct," and "independent judgment" as used in Section 2(11) of the Act:

> The authority to "assign" refers to "the act of designating an employee to a place (such as a location, department, or wing), appointing an employee to a time (such as a shift or overtime period), or giving significant overall duties, i.e., tasks, to an employee."
>
> The authority to "responsibly direct" arises "[i]f a person . . . decides 'what job shall be undertaken next or who shall do it,' . . . provided that the direction is both 'responsible' . . . and carried out with independent judgment. [F]or direction to be responsible, the person performing the oversight must be accountable for the performance of the task by the other."
>
> To exercise "independent judgment," an individual must "act, or effectively recommend action, free of the control of others and form an opinion or evaluation by discerning and comparing data. [A] judgment is not independent if it is dictated or controlled by detailed instructions . . . , the verbal instructions of a higher authority, or in the provisions of a collective bargaining agreement."

Implications of *Oakwood Healthcare* Decision Outside Healthcare Industry

Although the *Oakwood Healthcare* decision does stand for the proposition that charge nurses working in healthcare facilities (and, by analogy, lead persons in other industries) can be excluded from bargaining units as supervisors under the proper set of circumstances, the case draws no bright lines for determining when such persons will meet the test for supervisory status under the Act. In fact, the Board's analysis of the facts in the *Oakwood* decision itself clearly shows that the determination will continue to be made on an *ad hoc*, case by case, basis. This is especially true in industries outside healthcare where lead persons may not exercise the kind of independent judgment necessary to meet the Section 2(11) test for supervisory status.

For example, on the same day that the *Oakwood Healthcare* decision was released, the Board issued another decision applying the definitions for "assign" and "responsibly direct" as set forth in *Oakwood Healthcare* to lead persons working in a manufacturing plant. In *Croft Metals, Inc.*, 348 NLRB No. 38 (Sept. 29, 2006), the Board rejected the employer's claim that certain lead persons were supervisors because they did not exercise sufficient independent judgment in either assigning work to, or directing the work of, other employees.

In *Croft*, the Board first found that the lead persons did not possess the authority to "assign" other employees as that term is defined under the Act because the lead persons did not prepare the posted work schedules of the employees; did not appoint employees to production lines, departments, shifts or overtime periods; and did not give significant overall duties to other employees.

The Board did determine, however, that the lead persons "responsibly directed" their line or crew members. The Board said that the lead persons were required to manage their assigned teams, to correct improper performance, to shift employees, and to decide the order in which work was to be performed in order to achieve production goals. The Board further found that the lead persons were held accountable for the performance of their crew or line members. Nevertheless, the Board was still able to reject the employer's claim that the lead persons were supervisors under the Act by using the "independent judgment" definition set forth in *Oakwood Healthcare*.

The Board concluded that the employer failed to meet its burden to establish that the lead persons exercised independent

judgment in directing their crew or line members. The Board found that the lead persons' exercise of judgment was either fundamentally controlled by pre-established guidelines, such as delivery schedules, or was simply "routine." Accordingly, the Board determined that the lead persons were not supervisors and were eligible to vote in the representation election.

Practical Implications of the Board's Revised Test for Section 2(11) Supervisory Status

The Board's revised test for supervisory status continues to be a highly fact-specific inquiry. Despite claims by unions that the *Oakwood Healthcare* decision "threatens the rights of millions of workers to join a union," the decision is likely to have only a minor impact on organizing activity outside the healthcare industry. Historically, lead persons in industries such as retail, manufacturing or construction exercise their supervisory authority only sporadically and then only under strict guidelines established by the employer. These individuals are likely to be ruled eligible to join a union.

In fact, if a union attempts to organize a group of employees at your facility and you face the prospect of a Board representation election, you may want your lead people to be eligible to vote in the election. This is especially true if you suspect the outcome of the election may be a close one and your charge nurses or your lead people are likely to be loyal to management. On the other hand, you should also remember that, if the union wins the election, whoever is in the voting unit will usually be part of the bargaining unit. Thus, you may want to argue that your lead people are statutory supervisors.

The supervisory status issue can also arise in unfair labor practice proceedings where an employer is accused of wrongfully discharging an employee because of his or her activities on behalf of a union. Even assuming an employer's decision to discharge a lead person was motivated by the employee's interest in a union, the employer will normally escape liability under the Act if it can show that the lead person qualifies as a Section 2(11) supervisor.

The recent decisions by the NLRB on the issue of statutory supervisors make it clear that employers will not be able to convincingly argue that their lead people are supervisors unless the lead people regularly make assignments using independent discretion or responsibly direct other employees with accountability for their performance. Employers can plan for such an argument now by auditing the responsibility and performance of any putative supervisor to ascertain whether such factors match the various criteria used by the Board to find supervisory status under the Act.

California Alert:
New Employment Laws for 2007

For employers with California operations or employees who regularly work in California, be aware of new employment-related laws that took effect in January 2007. The new provisions include:

- raising the minimum wage from $6.75 per hour to $7.50, with another raise to $8.00 per hour in January 2008
- requiring harassment training for supervisors of employers with 50 or more employees (All the employees need not be housed in California, but the training requirement applies only to supervisors working in California.)
- easing pay stub reporting requirements for overtime premiums paid in consecutive pay periods
- prohibiting sexual orientation discrimination in the conduct or operation of state or state-funded programs and activities (The new law applies to any program operated or funded by the state or that receives any financial assistance from the state.)
- banning the use of hand-held cellular phones while driving a vehicle (This law is not effective until July 1, 2008.)

IRS Announces COLA Adjustments to Benefit Plan Limitations for 2007

Effective date: January 1, 2007

MAXIMUM DOLLAR LIMITS

	2007	2006	2005	2004	2003	2002	2001
401(k) & 403(b) Elective Deferrals	$15,500	$15,000	$14,000	$13,000	$12,000	$11,000	$10,500
Catch-Up Elective Deferrals	$5,000	$5,000	$4,000	$3,000	$2,000	$1,000	N/A
Defined Benefit Plan Benefit	$180,000	$175,000	$170,000	$165,000	$160,000	$160,000	$140,000
Defined Contribution Plan Contribution	$45,000	$44,000	$42,000	$41,000	$40,000	$40,000	$35,000
Annual Compensation Limit	$225,000	$220,000	$210,000	$205,000	$200,000	$200,000	$170,000
457 Deferral	$15,500	$15,000	$14,000	$13,000	$12,000	$11,000	$8,500
Highly Compensated Employee	$100,000	$100,000	$95,000	$90,000	$90,000	$90,000	$85,000
SIMPLE Plan Deferral	$10,500	$10,000	$10,000	$9,000	$8,000	$7,000	$6,500
SIMPLE Plan Catch-Up Elective Deferrals	$2,500	$2,500	$2,000	$1,500	$1,000	$500	N/A
SEP Coverage	$500	$450	$450	$450	$450	$450	$450
SEP Compensation	$225,000	$220,000	$210,000	$205,000	$200,000	$200,000	$170,000
Tax Credit ESOP Maximum Balance	$915,000	$885,000	$850,000	$830,000	$810,000	$800,000	$780,000
Amount for Lengthening of 5-year ESOP Period	$180,000	$175,000	$170,000	$165,000	$160,000	$160,000	$155,000
PBGC Monthly Maximum Guarantee	$4,125.00	$3,971.59	$3,801.14	$3,698.86	$3,664.77	$3,579.55	$3,392.05
Social Security Tax Wage Base	$97,500	$94,200	$90,000	$87,900	$87,000	$84,900	$80,400
FICA Tax for employees and employers	7.65%	7.65%	7.65%	7.65%	7.65%	7.65%	7.65%
Social Security Tax for employees and employers	6.2%	6.2%	6.2%	6.2%	6.2%	6.2%	6.2%
Medicare Tax for employees and employers	1.45%	1.45%	1.45%	1.45%	1.45%	1.45%	1.45%

FICA Tax for self-employed workers	15.3%	15.3%	15.3%	15.3%	15.3%	15.3%	15.3%
Social Security Tax for self-employed workers	12.4%	12.4%	12.4%	12.4%	12.4%	12.4%	12.4%
Medicare Tax for self-employed Workers	2.9%	2.9%	2.9%	2.9%	2.9%	2.9%	2.9%
HSA Contribution Single Family	$2,850 $5,650	$2,700 $5,450	$2,650 $5,250	$2,600 $5,150	N/A	N/A	N/A
HSA Catch-Up	$800	$700	$600	$500	N/A	N/A	N/A
HDHP Deductible Single Family	$1,100 $2,200	$1,050 $2,100	$1,000 $2,000	$1,000 $2,000	N/A	N/A	N/A
HDHP Out-of-Pocket Single Family	$5,500 $11,000	$5,250 $10,500	$5,100 $10,200	$5,000 $10,000	N/A	N/A	N/A

Pension Protection Act of 2006 – How Will It Affect Your 401(k) Plan or Other Defined Contribution Plan?

By: Martha L. Hutzelman

The Pension Protection Act of 2006 ("PPA") was enacted on August 17, 2006. This new law provides for significant changes to all types of employee retirement benefit plans. This article provides a general overview of some of the changes in the PPA that will affect 401(k), money purchase pension and other types of defined contribution plans and, in certain cases, 403(b) and 457(b) plans.

Most of these rule changes are effective in 2007. Thus, calendar year plans should be currently operating in compliance with many of these changes.

New Accelerated Vesting Schedule

The vesting schedule that may be used for all employer contributions to a defined contribution plan is accelerated under the PPA. Under the new rules, all employer contributions must vest on a three-year cliff or a six-year graded vesting schedule. This is the same vesting schedule that currently applies to employer matching contributions made to 401(k) and similar types of plans. These new vesting rules are effective for contributions made for plan years beginning after December 31, 2006.

The Internal Revenue Service ("IRS") recently issued guidance that permits a plan to include two separate vesting schedules: one for employer contributions made for plan years beginning on or before December 31, 2006 and one for employer contributions made for plan years beginning after December 31, 2006. To have two different vesting schedules, the plan must be able to separately account for each category of employer contributions. (See, IRS Notice 2007-7.)

Plan Distribution Changes

Various changes to distribution rules for defined contribution plans were included in the PPA. These new rules included the following changes to expand hardship

distributions, permit direct rollovers for non-spouse beneficiaries, recognize certain qualified domestic relations orders, provide for in-service distributions for money purchase pension plans, permit penalty-free early withdrawals for certain military reservists, permit rollovers to Roth IRAs and modify notice and consent rules for distributions.

Hardship Distribution Expansion

401(k) and 403(b) plans are permitted to allow hardship distributions for medical, tuition and funeral expenses to be used for a primary beneficiary under the plan. A primary beneficiary is defined as an individual who is named as a beneficiary and has an unconditional right to all or a portion of the participant's account balance upon the participant's death. Similarly, when determining plan distributions that may be made pursuant to an unforeseeable emergency, 457(b) and 409A plans may treat a participant's beneficiary the same as the participant's spouse.

These changes are effective beginning August 17, 2006. Plans are permitted to use these rules, but are not required to follow them. If these discretionary rules are used, the plan must be amended to include these new rules.

Direct Rollovers for Non-Spouse Beneficiaries

Plans are permitted under the PPA to allow a participant's non-spouse beneficiary to elect to have his plan distribution directly rolled over to an individual retirement account ("IRA"). This IRA must be named as an inherited IRA held for the benefit of the beneficiary. The distribution must be directly transferred to the inherited IRA (i.e., the 60-day rollover rule does not apply in this situation).

This change is effective for distributions made from any type of defined contribution, 403(b) or governmental 457(b) plan on or after January 1, 2007. Plans are permitted to use this rule, but are not required to follow it. If this discretionary rule is used, the plan must be amended to include this new rule.

Qualified Domestic Relations Order ("QDRO") Timing and Order

The PPA provides that a domestic relations order that otherwise satisfies the requirements for a qualified domestic relations order ("QDRO") will not fail to be treated as a QDRO solely because the order is issued after, or revises, another QDRO or the order is issued after the death or divorce of the participant.

The DOL issued regulations that include examples of how to treat such domestic relations orders. These regulations are effective as of April 6, 2007, but may be currently relied upon by plan administrators in making QDRO determinations, since the guidance is intended to be a clarification of rules already in existence.

In-Service Distributions At Age 62 for Money Purchase Pension Plans

For money purchase pension plans and other types of plans that have annual fixed contributions, in-service withdrawals may be made by participants on or after the date that the participant attains age 62 pursuant to the PPA. For other types of defined contribution plans, such as 401(k) plans, in-service withdrawals are already permitted to be made to any participant who has attained age 59-1/2.

This change is effective beginning August 17, 2006. Plans are permitted to use this rule, but are not required to follow it. If this discretionary rule is used, the plan must be amended to include this new rule.

No Early Withdrawal Penalty for Certain Military Reservists

The PPA permits military reservists who are called up for active duty between

September 11, 2001 and December 31, 2007, for a period of 180 days or more to take a distribution of employee elective deferrals from a 401(k) or 403(b) plan or of any amount from an IRA without incurring the 10% early distribution tax. The distribution must be made after September 11, 2001.

The amount may be recontributed to an IRA within two (2) years after the later of the end of active duty service or August 17, 2006. Reservists who have already paid the 10% early distribution tax may file for a refund within three (3) years of the income tax filing date.

Rollovers to Roth IRAs Permitted

Effective January 1, 2008, distributions made from 401(k), money purchase pension and other types of defined contribution plans, 403(b) plans and governmental 457(b) plans may be rolled over directly to Roth IRAs without the intermediate step of rollover to a traditional IRA. The employee must pay ordinary federal income tax on the amount of the distribution, but not the 10% early distribution tax which currently applies if such amounts are transferred to a Roth IRA.

Employer plans are permitted to allow direct rollovers to Roth IRAs , but not required to offer such rollovers. Employers will need to review the administrative burdens associated with implementing this rule prior to determining whether to adopt it in the employer plan. If this discretionary rule is used, the plan must be amended to permit direct rollovers to Roth IRAs.

New Notice and Consent Rules for Distributions

Special tax notices that must be issued before plan distributions are made may now be provided to the participant or beneficiary no more than 180 days before the distribution date. Previously, such notices had to be provided no more than 90 days before the distribution date.

Additionally, the special tax notice must now describe a participant's right to defer a distribution and the consequences of failing to defer a distribution. For defined contribution plans, the notice must also include a description of the investment options (including fees) available if distributions are deferred and any information in the plan's summary plan description that might materially affect a participant's decision to defer.

These special tax notice rule changes are effective for plan years beginning after December 31, 2006. Thus, calendar year plans should be complying with these rules for all distributions made in 2007.

The IRS has not yet issued a model special tax notice. Until a model special tax notice is issued, employers must exhibit a good faith attempt to comply with these new rules by providing a description including this new information that is written in a manner that may be reasonably understood by the average participant.

Quarterly / Annual Benefit Statements Required

The PPA now requires that quarterly benefit statements must be provided to participants in self-directed plans (i.e., plans with participant-directed investments) and annual benefit statements must be provided to participants in all other types of defined contribution plans, beginning with plan years beginning in 2007. Under previous law, a benefit statement was only required to be issued when a participant requested the statement.

The U.S. Department of Labor ("DOL") has subsequently issued guidance clarifying that the benefit statement must be issued within 45 days after the end of the quarter or plan year. (See, DOL Field Assistance Bulleting ("FAB") 2006-3.) Thus, a calendar year plan that has participant-directed investments must provide the first quarterly benefit statement required under the PPA for the quarter ending March 31, 2007, no later

than May 15, 2007. Similarly, a calendar year defined contribution plan that does not have participant-directed investments must provide the first annual benefit statement under the PPA no later than February 14, 2008.

The PPA requires that the quarterly statement for a plan with participant-directed investments must include the following information:

(1) the participant's total accrued benefit (i.e., total account balance);

(2) the vested portion of the total benefit;

(3) the value of each investment in which assets of the participant's account are allocated, including the value of any employer securities;

(4) an explanation of any limitations or restrictions on the participant's right to direct an investment;

(5) an explanation of the importance of diversification and the risk of holding more than twenty percent (20%) of the value of the account in a single investment; and

(6) a notice directing the participant to the DOL's website for information on investing and diversification (see, www.dol.gov/ebsa/investing.html.

Participant Investment Advice

Beginning in 2007, an investment fund provider under a 401(k), 403(b), 457(b) or other defined contribution plan may provide personal investment advice to plan participants without violating prohibited transaction rules if certain criteria are met. These rules include, but are not limited to, the following requirements:

(1) the fees received by the advisor cannot vary depending on the investment option selected or the advice must be provided under a computer model that is certified by an independent party pursuant to standards set by the DOL;

(2) before the investment advice is given, participants must receive a disclosure of the compensation paid to the advisor and other information regarding the investment advice program;

(3) investment transactions may only occur at the direction of the participant;

(4) the investment advice program must be authorized by a plan fiduciary other than the entity providing the advice;

(5) the investment advice program must be subject to an independent annual audit verifying compliance with these rules; and

(6) the investment advisor must retain evidence of compliance with these rules for six (6) years.

The employer is responsible for selecting and monitoring the advisors who will be permitted to provide personal investment advice to plan participants. However, the employer is not responsible for monitoring the specific investment advice given to any one plan participant.

Plans are permitted, but not required, to offer personal investment advice to plan participants. If personal investment advice is offered under the plan, the plan and plan fiduciary procedures must be amended to include these new requirements.

Safe Harbor Automatic Enrollment in 401(k) Plan

Effective in 2008, if automatic enrollment is offered under a 401(k) plan in compliance with safe harbor features set out in the PPA, the 401(k) plan will not be subject to annual

deferral percentage and contribution percentage (ADP and ACP) testing to determine if the plan is providing benefits on a non-discriminatory basis to non-highly compensated employees.

In order to meet the automatic enrollment safe harbor requirements, the 401(k) plan must:

(1) automatically enroll all participants who do not affirmatively opt out of plan participation;

(2) provide for an initial automatic employee deferral contribution of 3% of compensation with a minimum escalation rate of 1% of compensation per year for 3 years (up to a maximum automatic deferral rate of 6%);

(3) not require a deferral election in excess of 10% of compensation;

(4) provide for a minimum employer contribution that is either:

(a) a nonelective contribution that is at least 3% of compensation or

(b) a matching contribution that is at least a $1/$1 match on the first 1% of compensation deferred and $.50/$1 match on the next 5% of compensation deferred;

(5) provide for 100% vesting of all employer contributions after two (2) years of service; and

(6) satisfy other current safe harbor 401(k) requirements, such as participant notification of the safe harbor provisions at least thirty (30) days prior to the beginning of each plan year and plan withdrawal restrictions.

The automatic enrollment safe harbor 401(k) is effective for plan years beginning after December 31, 2007. The DOL has issued proposed regulations that provide fiduciary liability relief if plan contributions made under automatic enrollment safe harbor plans and other types of default investments are invested in a qualified default investment alternative. In addition to meeting other requirements, a qualified default investment alternative must be invested in one of three types of investment products:

(1) a life-cycle or target retirement date fund or account;

(2) a balance fund or

(3) an investment management service.

Permanent Extensions of EGTRRA Rules

The PPA makes permanent all of the retirement plan enhancements included in the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"). These provisions include the substantially increased annual plan contribution limits (such as the increase of the 401(k) elective deferral limit from $10,500 in 2001 to $15,500 for 2007), the ability to make catch-up contributions and more flexible plan rollover rules (such as more permissible rollovers between 401(k), 403(b) and governmental 457(b) plans). Under prior law, the enhancements included in EGTRRA were scheduled to expire in 2010.

The PPA also makes permanent the Saver's Credit of up to $2,000 per year that was enacted in EGTRRA. The Saver's Credit provides a non-refundable income tax credit to individuals who make contributions to 401(k) plans, IRAs and other types of retirement plans. Joint returns with adjusted gross income of $50,000 or less, head of household returns of $37,500 or less and single returns of $25,000 or less are eligible for the credit. Under prior law, the Saver's Credit was scheduled to expire at the end of 2006. Starting in 2007, the maximum amount of the annual Saver's Credit will now be indexed for inflation in multiples of $500.

Conclusion

This is only a general overview of several of the changes impacting 401(k), money purchase pension, 403(b), 457(b) and other types of defined contribution plans that are included in the PPA. In addition to more specific requirements included in the PPA, the IRS and DOL will continue to issue detailed guidance regarding new PPA rules. Therefore, as with all benefit plan changes, employers are advised to seek legal assistance in amending plan documents, preparing employee communications and changing plan operations to incorporate new PPA requirements.

Attorneys In The News

Recognitions

- The Firm congratulates **John G. Kruchko** on his selection as one of D.C.'s best labor and employment law lawyers listed in the D.C. Super Lawyers of 2007.
- **Martha L. Hutzelman** is recognized as one of the nation's best employee benefits lawyers in the 2007 edition of *The Best Lawyers in America*.

Presentations and Seminars

- **Martha L. Hutzelman** will give presentations at the AICPA Employee Benefits Conference in New Orleans, LA on May 23, 2007, on "Compensation and Other Issues in Mergers and Acquisitions" and "Introduction to Compensation and Benefits Research."
- On April 26, 2007, **Martha L. Hutzelman** will moderate a panel presentation entitled: "DOL Update: Pension Protection Act Compliance, Fiduciary Best Practices and Form 5500 Reporting" at the IRS-ASPPA Mid-Atlantic Benefits Conference in Philadelphia, PA.
- In January 2007, **John G. Kruchko** discussed "Emerging Issues in Employment Law" with members of WTPF: The Business Forum for HR Professionals.
- **Jay R. Fries** gave a presentation on "Wage and Hour Law: Answers to Everyday Questions" before the National Business Institute in November 2006.

Kruchko & Fries

Management Labor, Employment & Employee Benefits Law

1750 Tysons Boulevard * Suite 560 * McLean, VA 22102 * (703) 734-0554 * Fax (703) 734-0876

502 Washington Avenue * Suite 400 * Baltimore, MD 21204 * (410) 321-7310

601 Pennsylvania Avenue, N.W. * Suite 900 * Washington, DC 20004 * (202) 347-6550

www.kruchkoandfries.com

Any U.S. Federal tax information contained in this communication (or in any attachment) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code of 1986, as amended, or (ii) promoting, marketing or recommending to another party any Federal tax transaction or matter addressed in this Kruchko & Fries Management Labor, Employment & Benefits News.