

MESSAGE FROM THE CHAIR TO THE FRIENDS OF COZEN O'CONNOR:

Our Summer 2008 *Labor and Employment Law Observer* covers a multitude of topics of interest to in-house counsel, human resources professionals and corporate management.

Recently, President Bush signed the Genetic Information NonDiscrimination Act ("GINA") into law, which prohibits discrimination on the basis of genetic information. The employment discrimination components of the new law go into effect in November 2009. Additionally, during the past few months, the Supreme Court issued rulings in at least two cases that have an impact on employers. In *Meachan v. Knolls*, the Supreme Court made it harder for employers to defend disparate impact claims under the ADEA following a reduction-in-force. In *Metropolitan Life Insurance Company v. Glenn*, the Supreme Court refined the standard of review applicable to benefits denial claims under ERISA where the plan administrator both determines plan eligibility and pays the benefits.

Of importance to some employers, the federal minimum wage recently increased to \$6.55 an hour, although in Pennsylvania, the minimum wage is now \$7.15 an hour.

Finally, we wanted to note that Cozen O'Connor Labor & Employment member Ray Kresge successfully argued a case before the U.S. Court of Appeals for the Third Circuit regarding the arbitrability of denials of ERISA benefit claims. We are also happy to report that our Group was recognized again this year by *Chambers USA* as one of the country's leading labor and employment practices.

You can read about these and other recent labor and employment developments in this issue of the *Observer*.

We welcome your inquiries on the articles in this *Observer*, other matters of interest to you and suggestions for future topics.



Mark Foley
Chair, Labor & Employment

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SUPREME COURT INCREASES BURDEN OF PROOF FOR EMPLOYERS IN DISPARATE IMPACT ADEA CASES

Anita B. Weinstein, Esq.

The Supreme Court recently made it harder for employers to defend disparate-impact claims following a reduction in force under the Age Discrimination in Employment Act (ADEA).

In *Meacham, et al. v. Knolls*, (Supreme Court, No. 06-1505, 6/19/08), the Supreme Court held that employers “facing a disparate-impact claim and planning to defend on the basis of RFOA [reasonable factors other than age] must not only produce evidence raising the defense, but also persuade the fact finder of its merit.” The Supreme Court held that employers must do both.

This raises the burden for employers and lowers the burden for employees, who must now only identify a specific employment practice which has a disparate impact. This shifts the burden to the employer to produce evidence that the employment decision was based on RFOA **and** meet the burden of proof on this point.

The result is that the employee’s burden is less under the ADEA for disparate-impact cases than it is for other discrimination cases.

HISTORY OF THE LAWSUIT

Knolls was the operator of the Knolls Atomic Power Laboratory which had been in existence since the 1940’s. Knolls’ operations were funded by the United States Navy and the Department of Energy. In 1996, Knolls was ordered to reduce its work force due to changing demands for its product. Approximately 100 employees accepted the company’s buy-out offer, which was approximately 30 jobs short of the goal. In determining which additional 30 employees to be laid off, Knolls told its managers “to score their subordinates on three scales, ‘performance,’ ‘flexibility,’ and ‘critical skills.’” 31 salaried employees were laid off. 30 of the 31 salaried employees were 40 years old or older. Meacham and 27 others sued Knolls on the basis of both disparate treatment and disparate-impact

under the ADEA and state law. According to *Meacham*, “to show a disparate impact, the workers relied on a statistical expert’s testimony to the effect that results so skewed according to age could rarely occur by chance; and that the scores for ‘flexibility’ and ‘criticality’ over which managers had the most discretionary judgment, had the firmest statistical ties to the outcomes.”

The Supreme Court twice remanded the matter to the Second Circuit Court of Appeals after vacating judgment. Justice Souter wrote the most recent Opinion.

SECTION 623(F) OF THE ADEA PROVIDES AN AFFIRMATIVE DEFENSE

The ADEA prohibits discrimination on the basis of age, protecting the rights of individuals who are forty years old or older. In deciding *Meacham*, the Supreme Court relied on §623(f) of the ADEA which provides:

It shall not be unlawful for the employer...to take any action otherwise prohibited under Subsections (a), (b), (c) or (e) ... where age is a bona fide occupational qualification reasonably necessary to the normal operation of the particular business, or where the differentiation is based on reasonable factors other than age ...

The Supreme Court considered that a bona fide occupational qualification (BFOQ) and reasonable factors other than age (RFOA) were two of the five affirmative defenses available under the ADEA. As such, the burden of proving an affirmative defense rests on the party asserting the defense. In *Meacham*, the party is the employer.

The Court relied on those cases analyzing the BFOQ defense as well as defenses to the Equal Pay Act of 1963. The Court concluded that a defense based on RFOA should be treated exactly the same as the defenses to the Equal Pay Act, the FLSA and the BFOQ defense to the ADEA.

PLAINTIFF MUST IDENTIFY A SPECIFIC PRACTICE

The Court, however, concluded that the plaintiff must do more than allege a disparate impact. The plaintiff must identify a specific practice which led to the disparity. The Court stated that the impact of this decision will “be mainly in cases where the reasonableness of the non-age factor is obscured

for some reason, that the employer will have more evidence to reveal and more convincing to do in going from production to persuasion.” But the Court noted that “there is no denying that putting employers to the work of persuading factfinders that their choices are reasonable makes it harder and costlier to defend than if employers merely bore the burden of production ...”

IMPACT OF MEACHAM

The impact of the *Meacham* opinion is to apply a more rigorous burden of proof on the employer in defending disparate-impact claims under the ADEA following a reduction in force.

Meacham requires that employers must meticulously document the basis of the selection process for reductions in force which impact older workers. Employers will now have the burden of proof as well as the burden of production of evidence supporting their decisions when a reduction in force results in a disparate impact claim. Reasonable factors other than age may still be a viable affirmative defense, but employers now have the burden to prove the factors. Vague explanations will be insufficient to meet this stricter burden of proof.

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HEALTHY WORKFORCE INITIATIVES: MANDATORY WELLNESS PROGRAMS

Tiffani L. McDonough, Esq.

Most employees typically spend more than half of their waking hours at work. Unsurprisingly, work culture can have a serious impact on employee health. As a result, many employers have designed wellness programs to promote a healthier work environment. These programs are designed to prevent and manage diseases in an effort to maintain employee health and productivity. Another significant consideration for implementing a wellness program is combating the rising costs of health care coverage. Specifically, these programs are created to encourage employees to adopt a healthier lifestyle with the expectation that such behavioral changes create a healthier work force resulting in lower employer insurance premiums. Because certain preventable health conditions, such as obesity and tobacco-related illnesses, are significantly contributing to the overall decline in employee health and rising expense of health care coverage, employers are responding by providing services such as discounted gym memberships and employee assistance programs wherein employees can obtain nutritional counseling and/or health coach services.

Although voluntary wellness programs are quite common, employers are increasingly implementing mandatory wellness programs, which require an employee to participate in the program or otherwise suffer a penalty. These programs require,

“...specifically, these programs are created to encourage employees to adopt a healthier lifestyle with the expectation that such behavioral changes will in turn create a healthier work force resulting in lower employer insurance premiums.”

for example, that employees take a health risk assessment as a requirement of eligibility for health insurance coverage or participate in weekly stress management classes. Some more stringent programs require employees to refrain from unhealthy lifestyle choices, such as tobacco use or poor dietary choices. In some cases, employers monitor employees’ lifestyle choices by mandating that employees participate in testing. For instance, if the mandatory wellness program requires

employees to refrain from tobacco use, the employer may require the employees to undergo periodic nicotine testing.

AVOIDING THE LEGAL PITFALLS

In order to avoid litigation, employers must strike the proper balance between mandatory wellness programs and employee rights. As an initial matter, employers should have a business objective when implementing a mandatory wellness program. The business objective may be as simple as stress reduction at work. Nonetheless, employers should be able to link the goals of the wellness program to employee job performance.

Compliance With the Americans With Disabilities Act

Employers must be careful in designing mandatory wellness programs to ensure compliance with the law. Such programs, if not properly administered, may face a myriad of legal challenges under federal anti-discrimination statutes and privacy laws. One of the biggest challenges employers face is reconciling mandatory wellness programs with the requirements of the Americans With Disabilities Act (ADA). The ADA prohibits employers from discriminating against a qualified individual with a disability in any aspect of employment including employee compensation and benefits. Specifically, employers must be mindful of the ADA's confidentiality requirements. For example, the ADA limits the disclosure of employee medical information. Therefore, an employer should retain an independent third party administrator to collect and analyze medical information obtained in connection with a mandatory wellness program to ensure that individual health data is not disclosed to the employer. Additionally, employers must be cognizant that although a disabled individual can perform the essential functions of his/her position, he/she may not be able to maintain certain health criteria required by the wellness program because of his/her disability. For example, a disabled employee may not be able to maintain a set body mass index because of certain health conditions.

Title VII of the Civil Rights Act

Another factor employers should consider when implementing a mandatory wellness program is the implications of Title VII. As a practical matter, gender differences should be factored into the goals of the program. For example, a healthy body mass index for women is higher than it is for men. As such, both male and female employees should be held to the medically accepted standards of their respective gender.

State Law Protections Afforded to Lawful Off-Duty Conduct

Likewise, because many states have statutes which protect employees from adverse employment actions for lawful off-duty conduct, employers need to take caution when regulating employees outside of the work place. For example, under New York law, employers generally may not take adverse action against employees for any otherwise lawful off-duty conduct. Some states limit the scope of protection to specific off-duty conduct. In New Jersey, for example, an employer may not take adverse action against employees for the use of tobacco products. Consequently, mandatory wellness programs applicable to employees in states with such statutory protections may not penalize employees for their lawful off-duty conduct. As such, employers must consult relevant state legislation when implementing mandatory wellness programs.

MANDATORY VS. VOLUNTARY: BALANCING THE BENEFITS AND RISKS

Before implementing a mandatory wellness program, employers should take a close look at the benefits and accompanying risks of such programs. Although voluntary wellness programs do not guarantee 100% employee participation, such programs carry a lower risk of potential legal challenges. Therefore, employers must carefully weigh the incentives of mandatory wellness programs against the inherent legal risks. As a practical matter, employers should first implement a voluntary wellness program and later evaluate the percentage of employee participation. If employee participation is high, it may be unnecessary for the employer to implement a mandatory program. Alternatively, if participation in the program is low, an employer may want to consider implementing a mandatory program.

It is axiomatic that a healthier workforce will increase overall employee productivity and result in a reduction in health care costs. Although many employees appreciate the availability and benefits of an employer sponsored wellness program, employers must be mindful of the limitations inherent in mandatory wellness programs and ensure that such programs are compliant with both state and federal law.

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METROPOLITAN LIFE INSURANCE COMPANY V. GLENN: Supreme Court Holds Financial Conflicts of Interest Must Be Weighed as a Factor in Reviewing Benefit Determinations By ERISA Plan Administrators

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On June 19, the Supreme Court issued its decision in *Metropolitan Life Insurance v. Glenn*, 128 S.Ct. 2343 (June 19, 2008), the Court's first attempt to refine the standard of review applicable to benefits denial claims under ERISA since its seminal decision nineteen years ago in *Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101 (1989). The Court's decision in *Metlife* expands upon *dictum* in *Firestone*, in which the Court stated that "if a benefit plan give discretion to an administrator or fiduciary who is acting under a conflict of interest, that conflict must be weighed as a 'facto[r]' in determining whether there is an abuse of discretion." *Firestone*, 489 U.S. at 115. In *Metlife*, the Court expressly adopted this statement from *Firestone*, and held that when an ERISA plan administrator, whether an employer or an insurance company, "both determines whether an employee is eligible for benefits and pays benefits out of its own pocket ... this dual role creates a conflict of interest; that a reviewing court should consider that conflict as a factor in determining whether the plan administrator has abused its discretion in denying benefits; and that the significance of the factor will depend upon the circumstances of a particular case."

The Court's decision in *Metlife* includes several key points with respect to judicial review of benefits denials by conflicted plan administrators. In particular, the Court reiterated that trust law governs the standard of review in all ERISA benefits denial cases. Applying principles of trust law, the Court also emphasized that when plan documents give a plan administrator discretionary authority to decide claims, a reviewing court is to apply a deferential abuse of discretion standard when reviewing that administrator's decisions, even if the administrator has a conflict of interest. As the Court explained, "[t]rust law continues to apply a deferential standard of review to the discretionary decisionmaking of a conflicted trustee, while at the same time requiring the reviewing judge to take account of the conflict when determining whether the trustee, substantively or procedurally, has abused his discretion." However, the Court opted not to

provide "a detailed set of instructions" for the lower courts as to just how a reviewing judge is supposed to "take account of the conflict," noting that special burden of proof rules or other special procedural or evidentiary rules were neither "necessary [n]or desirable."

Instead, the Court encouraged judges reviewing benefits denials to take account of multiple different considerations "of which a conflict of interest is one," and weigh all of them together. In close cases, the Court suggested, any one factor may "act as a tie-breaker" depending upon the importance of that factor based on the facts of a particular case. In some cases, the financial conflict of interest may have greater importance, e.g. in "cases where an insurance company administrator has a history of biased claims." By contrast, the Court suggested that a conflict of interest "should prove less important (perhaps to the vanishing point) where the administrator has taken active steps to reduce potential bias and to promote accuracy, for example, by walling off claims administrators from those interested in firm finances, or by imposing management checks that penalize inaccurate decision making irrespective of whom the inaccuracy benefits."

"In Metlife, the Court...held that when an ERISA plan administrator, whether an employer or an insurance company, 'both determines whether an employee is eligible for benefits and pays benefits out of its own pocket ... this dual role creates a conflict of interest.'"

Because the Court's decision in *Metlife* does not, by design, impose any hard and fast rules for the lower courts to follow, the full impact of the decision must await further development in the various Courts of Appeals. In some circuits, particularly those that previously adopted a variation of the so-called "sliding scale" approach, in which the existence of a financial conflict of interest calls for the degree of scrutiny applied by the reviewing court to increase based on evidence of irregularities in the administrative review process, the Court's decision should have little immediate impact. In

other circuits where the Courts previously required a plaintiff to present evidence that a conflict of interest had actually tainted the review process, the decision obviously will change the way in which reviewing courts handle the conflict question.

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The most significant immediate impact of the Court's decision will likely be the importance placed on evidence that a plan administrator has taken steps to insulate the claims process from the financial side the business. While the Court's decision does not change the burden of proof in benefits denial cases (which remains always on the plaintiff challenging the denial), its decision does suggest that a plan administrator, whether an employer or an insurance company,

would be well-served to produce evidence of any steps taken to minimize the impact of any conflict of interest. The Court gave two examples of the types of steps that a plan administrator might take. For example, both the majority opinion and Justice Kennedy's partial concurrence suggested that an administrator might adopt procedures to insulate personnel reviewing claims from personnel responsible for managing firm finances – what Justice Kennedy repeatedly referred to at oral argument as creating a “firewall.” Alternatively, the Court suggested a plan administrator might adopt policies that promote accuracy in decision making by claims personnel, irrespective of whether the decision is to grant or deny benefits, for example by rewarding accuracy or punishing inaccuracy. Evidence of these sorts of efforts should help to diminish the importance a reviewing court will place on an administrator's conflict of interest.

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GENETIC INFORMATION NONDISCRIMINATION ACT BECOMES LAW

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After being debated in Congress for nearly fifteen years, President Bush signed the Genetic Information NonDiscrimination Act (“GINA”) into law on May 21, 2008. In the words of President Bush, GINA “protects our citizens from having genetic information misused.”

WHAT DOES GINA DO?

GINA prohibits employers and health insurers from discriminating on the basis of an individual's genetic information. The statute broadly defines genetic information as:

(A) In General - The term ‘genetic information’ means, with respect to any individual, information about -

- (i) such individual's genetic tests,
 - (ii) the genetic tests of family members of such individual, and
 - (iii) the manifestation of a disease or disorder in family members of such individual.
- (B) Inclusion of Genetic Services and Participation in Genetic Research - Such term includes, with respect to any individual, any request for, or receipt of, genetic services, or participation in clinical research which includes genetic services, by such individual or any family member of such individual.

Notably, the definition of genetic information *excludes* information about the sex or age of an individual.

In order to protect an individual's genetic information, GINA amends the Employee Retirement Income Security Act, Social Security Act, Health Insurance Portability and Accountability Act (“HIPAA”), and the IRS code, among other federal statutes.

For instance, GINA amends HIPAA to include genetic information within the meaning of "health information" under that statute. As a result, improper use or disclosure of genetic information is subject to HIPAA penalties.

With respect to employment, GINA prohibits employers (with 15 or more employees), employment agencies, and labor organizations from discriminating against individuals *based on* their genetic information. To this end, GINA states that it is unlawful for an employer:

- (1) to fail or refuse to hire, or to discharge, any employee, or otherwise to discriminate against any employee with respect to the compensation, terms, conditions, or privileges of employment of the employee, because of genetic information with respect to the employee; or
- (2) to limit, segregate, or classify the employees of the employer in any way that would deprive or tend to deprive any employee of employment opportunities or otherwise adversely affect the status of the employee as an employee, because of genetic information with respect to the employee.

GINA requires employees seeking protection under the statute to use the same procedures available to them under Title VII of the Civil Rights Act of 1964. As a result, any future claims arising under GINA must first be presented to the U.S. Equal Employment Opportunity Commission. The same remedies available to employees under Title VII are also available under GINA.

"...employers will need to be extremely cautious when making hiring/firing decisions concerning employees about whom they possess genetic information."

One key difference between GINA and Title VII is worth mentioning. Unlike Title VII, GINA does not permit employees to bring "disparate impact" claims. A disparate impact claim

generally arises when a facially neutral policy has an adverse impact on a group of individuals. While GINA does not currently permit such claims, the statute does create a Commission to review the developing science of genetics to make recommendations to Congress regarding whether to provide a disparate impact cause of action in the future.

WHAT ABOUT PROTECTING THE CONFIDENTIALITY OF GENETIC INFORMATION?

GINA also requires employers in possession of genetic information to maintain that information on separate forms and in separate medical files, and to treat this information as a confidential medical record. Thankfully, GINA states that an employer can protect the confidentiality of genetic information by maintaining and treating the information as a confidential medical record in accordance with the Americans With Disabilities Act. Therefore, employers can satisfy their confidentiality obligations simply by following their existing Americans With Disabilities Act procedures.

WHEN DOES GINA GO INTO EFFECT?

GINA does not go into effect immediately. The employment discrimination components do not kick in until November 21, 2009. In the interim, the U.S. Equal Employment Opportunity Commission will issue final regulations governing this part of the statute. The HIPAA aspects of GINA become effective in July 2009.

HOW DOES GINA IMPACT EMPLOYERS?

While the true impact of GINA is yet to be determined, this legislation provides employees an additional basis for filing lawsuits when genetic information is in play. As a result, employers will need to carefully consider whether they have any need to collect genetic information. And, of course, employers will need to be extremely cautious when making hiring/firing decisions concerning employees about whom they possess genetic information.

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THIRD CIRCUIT'S CLEAR STANDARD FOR ARBITRABILITY OF ERISA BENEFITS DENIALS

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Cozen O'Connor member Raymond A. Kresge successfully argued a recent case before the Third Circuit Court of Appeals involving an issue with wide-ranging implications for HR managers, labor unions, and employees alike. In deciding *United Steelworkers v. Rohm and Haas*, the Court held that, despite a broad arbitration clause in its collective bargaining agreement, Rohm and Haas could not be compelled to arbitrate disability benefits denials. In addition to setting forth a precedential standard for evaluating the arbitrability of denial of benefits claims, the Court also resolved some of the tension between the National Labor Relations Act ("NLRA") and the Employee Retirement Income Security Act ("ERISA") and provided several guideposts upon which employers can rely in crafting future labor agreements and benefits plans.

"...the Court held that, despite a broad arbitration clause in its collective bargaining agreement, Rohm and Haas could not be compelled to arbitrate disability benefits denials."

In this case, the employer, Rohm and Haas, denied the disability benefits claims of four employees represented by the United Steelworkers of America. The four employees had sought certain disability benefits under the Rohm and Haas Health and Welfare Plan. After the Plan's administrator denied their claims for benefits, the employees and the Steelworkers union demanded that Rohm and Haas submit to arbitration of the claims pursuant to the parties' collective bargaining agreement ("CBA").

Rohm and Haas refused to arbitrate the denials, arguing that because the Plan was not part of or incorporated into the CBA, it was not bound to do so under the CBA's arbitration clause. The Steelworkers promptly filed suit in federal court,

claiming that the CBA's broad arbitration clause compelled arbitration of the disability benefits claims. The district court sided with the Steelworkers, holding that in light of the strong federal policy favoring arbitration of disputes between parties to such an agreement, the clause should be read to cover benefits disputes under the Plan.

Despite the language in the CBA stating that "the provisions of this Agreement pertain only to the wages, hours, and working conditions of the . . . employees," the district court held that the parties intended to arbitrate disputes over disability benefits, and that such benefits were encompassed under the terms "wages" and "working conditions." The factors considered by the court included the summaries of the parties collective bargaining history and the fact that disability benefits had been the subject of negotiations between the parties for over 40 years. Though the CBA never referenced the Plan explicitly, the court held that there was sufficient extrinsic evidence to show the parties' intent to incorporate the Plan into the CBA's grievance procedure.

On appeal, the Third Circuit agreed with the district court in many respects, recognizing the strong federal presumption in favor of arbitration of labor disputes and the longstanding principle that "[d]oubts should be resolved in favor of coverage." The Third Circuit also agreed that, since the CBA's arbitration clause failed to explicitly limit the range of arbitrable subject matter, it should be viewed as broad in scope. According to the court, "Because there is neither an express provision excluding issues concerning disability benefits from arbitration nor forceful evidence of a purpose to exclude such benefits from the . . . CBA's grievance procedure, . . . the presumption of arbitrability applies."

However, despite this presumption, the Third Circuit reversed, holding that Rohm and Haas was not bound to arbitrate benefits disputes. In analyzing the particular plan at issue, the Court noted that despite its holding that the arbitration clause was broad, the underlying basis for the grievance must still arise from some specific article of the CBA before the employer could be compelled to arbitrate benefits claims. Here, the CBA did not contain any reference to or discussion of the employees rights to benefits under the Plan.

The Union had argued that disability benefits should be considered "working conditions," which were explicitly referenced in the CBA. In support, the Union pointed to authority

holding that the terms “wages” and “conditions of employment” as used in the NLRA were broad enough to include disability benefits. The Court disagreed, however, holding that “working conditions” were distinct from “conditions of employment,” and that the latter term was intended to have a broader meaning. Instead, the court held that “working conditions” was better defined as “the physical surroundings and hazards to a worker,” or “the physical surroundings of a worker at the place of employment,” and did not encompass disability benefits.

Furthermore, the court rejected the Steelworkers argument that a single reference to a “Sickness and Accident plan” within the CBA was sufficient to make disability benefits claims arbitrable. Instead, the court held that a mere reference to such a plan is insufficient to incorporate the entire Plan into the CBA, which contained no provisions defining the nature or extent of disability benefits. Finally, the court noted that the failure of the Plan itself to reference the CBA in either its own eligibility standards and claims procedures supported the conclusion that the parties did not intend to arbitrate such disputes.

In rendering its well-reasoned and thoughtful opinion, the Third Circuit provided a clear standard that can be used by employers who must evaluate the arbitrability of claims under existing CBAs and plans, and who must negotiate future agreements: “[T]here is no right to arbitration of ERISA benefits under a CBA unless the ERISA benefits sought are either: (i) derived directly from an ERISA plan established and maintained by or incorporated into a CBA whose grievance procedure

contains an arbitration clause, or (ii) created by a separate ERISA plan and that plan and/or the CBA provide that adverse benefit determinations by a plan administrator are subject to the CBA’s grievance procedure that includes arbitration.”

Under this standard, employers need not automatically submit to arbitration of disability benefits claims based solely on a broad arbitration clause in their existing CBAs. Instead, they should review both the CBA and the Plan document in detail to determine whether an intent to arbitrate such disputes can be inferred. Those seeking to craft new agreements to avoid future arbitrations of disability benefits denials should take care to avoid making reference to ERISA benefits plans within the CBA itself and, conversely, referring to the CBA in benefits plans.

Employers should also benefit from an understanding of the Court’s interpretation of the terms “working conditions” and “conditions of employment.” While it may seem that the two are interchangeable, the Third Circuit has made clear that each has its own meaning, and that “conditions of employment” has a far broader application. Employers should be mindful of this distinction when interpreting their existing CBAs, while those negotiating future agreements should be sure to use the term that will have the intended reach and effect.

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DEADLINE APPROACHES FOR AMENDING DEFERRED COMPENSATION ARRANGEMENTS UNDER SECTION 409A

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On April 10, 2007, the Internal Revenue Service (the “IRS”) and the Treasury Department issued final regulations regarding the taxation of non-qualified deferred compensation under Section 409A of the Internal Revenue Code of 1986, as amended (the “Code”). Code Section

409A provides that amounts deferred under non-qualified plans and arrangements may be subject to current taxation and penalties if certain requirements are not satisfied.

Although good faith compliance with the regulations is currently required, the IRS has granted extensions for compliance with the requirement that the terms of non-qualified deferred compensation plans and programs be amended to document compliance with the regulations (“Documentary Compliance”). Documentary Compliance is now required to be in place by December 31, 2008. The IRS has stated that there will be no further extensions. Additionally, the IRS has explicitly stated that, regardless of a plan’s operational compli-

ance, a failure to bring a non-qualified deferred compensation plan into Documentary Compliance will be considered a violation of Code Section 409A (triggering current taxation and penalties).

Basically, the 409A regulations require a plan to specify the amount to be paid, the date or event when deferred compensation will be paid and the form of payment. The regulations generally prohibit a further deferral or an acceleration of the time of payment. Events such as separation from service, death, disability, a change in control of the service provider or unforeseeable emergency, as defined in the regulations, are all permissible payment events. In addition, certain key employees of public companies may be required to wait 6 months before being paid any amount of "deferred compensation" following their separation from service. Linking payments under a deferred compensation plan to payments under a qualified plan is no longer permitted.

"The IRS has explicitly stated... a failure to bring a non-qualified deferred compensation plan into Documentary Compliance will be considered a violation of Code Section 409A (triggering current taxation and penalties)."

The regulations provide exceptions to the rules described above. For example, the regulations allow subsequent deferrals of deferred compensation if the individual receiving the compensation agrees to forego receipt for at least five years and makes the election at least one year before the payments would otherwise have been paid. The regulations also permit acceleration of benefits in the event the plan and all similar deferred compensation plans of the employer are terminated. The pre-409A practice of permitting an acceleration of benefits if the recipient was willing to accept a 10% "haircut" of the amount paid is prohibited.

Non-compliance with the regulations carries with it the potential for substantial tax penalties, which are borne by the individual who earns the compensation (i.e., the employee). If

a violation of Code Section 409A is discovered, the compensation becomes retroactively taxable to the date on which it originally vested. In addition to being required to restate his or her taxes for that year, the employee will owe interest and penalties from that date, as well as a 20% excise tax. States may also apply parallel penalties. It is possible, in some cases, for the amount of taxes owed to be greater than the compensation paid.

As noted above, these penalties are borne by the employee. However, because the compensation will generally be subject to payroll taxes, the employer also runs the risk of underpayment of taxes on the retroactively taxable compensation as well as failure to comply with reporting and withholding requirements.

Non-qualified deferred compensation is very broadly defined by the regulations. (Certain amounts are "grandfathered" and not subject to Section 409A if earned and vested as of December 31, 2004.) With certain exceptions, any form of compensation which is earned, or "vested" in one year, but actually paid in a subsequent year, may be subject to the rules. In addition to traditional deferred compensation plans, this can impact employment contracts, severance agreements, bonus plans, change in control agreements and even certain compensation arrangements with contractors. In general, stock options with an exercise price equal to the underlying stock's fair market value on the date of grant will generally be exempt from the rules. However, in certain circumstances, equity programs can become subject to Code Section 409A.

The first step employers must undertake to ensure compliance is to identify those plans or programs that may require review and amendment for compliance with the regulations. As noted above, a wide variety of compensation arrangements, including individual employment contracts, may fall under the Section 409A rules. It is vitally important that employers identify these programs as soon as possible to ensure that programs are compliant by December 31, 2008. Sufficient time should be allotted for coordination with executives, especially for bi-lateral arrangements, as well as the employer's compensation committee and board or other governing body.

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FEDERAL MINIMUM WAGE INCREASES TO \$6.55 PER HOUR

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On July 24, 2008, the federal minimum wage increased from \$5.85 to \$6.55 per hour. This was the second of three scheduled increases called for by the Fair Minimum Wage Act of 2007. On July 24, 2009 the final increase will take effect to lift the minimum wage to \$7.25 an hour. The U.S. Department of Labor has issued a Federal Minimum Wage Poster reflecting these changes. (The Fair Labor Standards Act (FLSA) requires that employers post a notice explaining the FLSA's requirements in a conspicuous place at all of their work sites). It is available free of charge on the Department of Labor's website at the following link: <http://www.dol.gov/esa/whd/regs/compliance/posters/flsa.htm>.

The law provides certain exceptions to the new minimum wage rate. For example, tipped employees can be paid a lower rate of \$2.13 an hour in direct wages so long as that amount plus the tips received equals the Federal minimum wage. Companies can also pay new employees under twenty (20) years of age a reduced "training wage" during their first ninety (90) days of employment.

It is important to note that states are free to set their own minimum wage rates higher than the Federal rate, and many have done so. For example, Pennsylvania's minimum wage is now \$7.15 an hour. New York, New Jersey and Delaware's

minimum wage rates are also currently set at \$7.15 an hour. Florida's is set at \$6.79 an hour. Approximately twenty (20) other states also have wage rates higher than the federal minimum. Where Federal and state law have different minimum wage rates, the higher rate must be paid to covered employees.

It is also important to note that these wage rates apply to employees covered by collective bargaining agreements, so that if a Company has an agreement which calls for wages below the new federal or state minimums, those wage rates will need to be adjusted in order to comply with the applicable minimum wage rates.

"Pennsylvania's minimum wage is now \$7.15 an hour."

These new minimum wage rates may require the attention of your human resources, payroll or compensation professionals to ensure compliance with federal and state wage and hour laws. If you would like to discuss any aspects of these changes and how they might impact your business or organization, please contact any of the Cozen O'Connor Labor and Employment Department lawyers.

For more information, please contact George A. Voegele, Jr., Esq. at 215.665.5595 or gvoegele@cozen.com.

COZEN O'CONNOR'S LABOR AND EMPLOYMENT PRACTICE RECOGNIZED BY CHAMBERS USA

Cozen O'Connor's Labor and Employment practice has once again been recognized as a leader in law in the 2008 Edition of *Chambers USA*, a guide listing the top lawyers and law firms in the country. In describing the practice, *Chambers* noted, "Interviewees praised the 'exceptionally meticulous and talented practitioners who take a genuine interest in the concerns of their clients.'"

Three of the firm's labor and employment attorneys were also honored by Chambers. **Mark J. Foley**, **Raymond A. Kresge** and **Jeffrey I. Pasek** were recognized as leading lawyers for their experience, skills and effective results.

To read the full Chambers comments, go to <http://www.cozen.com/cozendocs/Outgoing/msc/chambers-0708.pdf>.



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