HOT TOPICS IN EMPLOYEE BENEFITS

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Agenda

- Restrictive Covenants and Confidentiality Provisions Considerations
- Health and Welfare Plan Fiduciary Committee
- Special Financial Assistance Program: Highlights and Challenges
- Retirement Plan Update: SECURE 2.0 Update and Litigation Developments

Restrictive Covenants and Confidentiality Provisions Considerations

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FTC's Proposed Noncompete Rule

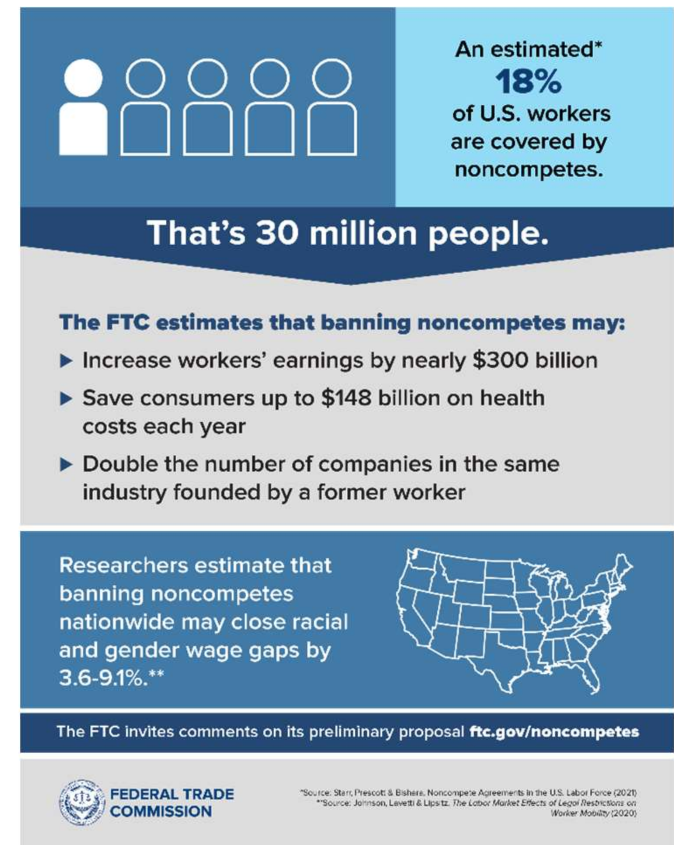
- Proposed Rule Text:

  Unfair methods of competition. It is an unfair method of competition for an employer to enter into or attempt to enter into a non-compete clause with a worker; maintain with a worker a non-compete clause; or represent to a worker that the worker is subject to a non-compete clause where the employer has no good faith basis to believe that the worker is subject to an enforceable non-compete clause.

- Proposed Rule Would:
  - **Ban noncompetes with "workers"**
    - Broad definition of "workers": any person "who works, whether paid or unpaid, for an employer."
    - Applies to explicit and de facto noncompetes.
  - **Require rescission of existing noncompetes**, with notice to workers.
  - Only **exception in connection with sale of business**, for noncompetes applicable to "substantial owners," which is defined to mean those owning more than 25% of business.

FTC's Proposed Noncompete Rule cont'd

- FTC has and is considering alternatives, and has specifically requested comments on:
  - Alternative #1 would categorically ban the use of noncompete clauses for some workers and apply a rebuttable presumption of unlawfulness to noncompete clauses for other workers.
  - Alternative #2 would categorically ban the use of noncompete clauses for some workers and not apply any requirements to other workers.
  - Alternative #3 would apply a rebuttable presumption of unlawfulness to noncompete clauses for all workers.
  - Alternative #4 would apply a rebuttable presumption of unlawfulness to noncompete clauses for some workers and not apply any requirements to the other workers.
- <u>**COMMENTS DEADLINE: MARCH 20, 2023**</u>



Proposed Ban on "De Facto" Noncompetes

- *Functional test for whether a contractual term is a noncompete clause.* The term noncompete clause includes a contractual term that is a de facto noncompete clause because it has the effect of prohibiting the worker from seeking or accepting employment with a person or operating a business after the conclusion of the worker's employment with the employer. For example, the following types of contractual terms, among others, may be de facto noncompete clauses:
  - i. A nondisclosure agreement between an employer and a worker that is written so broadly that it effectively precludes the worker from working in the same field after the conclusion of the worker's employment with the employer.
  - ii. A contractual term between an employer and a worker that requires the worker to pay the employer or a third-party entity for training costs if the worker's employment terminates within a specified time period, where the required payment is not reasonably related to the costs the employer incurred for training the worker.

Overly Broad Confidentiality Clauses Can Be De Facto Noncompete Clauses

- In considering whether a confidentiality agreement operates as a de facto noncompete, we anticipate that courts will likely consider whether the agreement has temporal and geographic limitations, and scrutinize the scope of the confidentiality clause and its exceptions to determine if, for example, the employer is precluding the former employee from using any of the following:
  - Any and all information received, encountered, or learned during the employment
  - Any and all information that is used or usable in; originated, developed, or acquired for use in; or about or relating to an entire industry
  - General knowledge, skill, or facility acquired through training or experience
  - Information that is not in fact confidential, proprietary, or trade secret information because it is public knowledge or readily accessible through legitimate means
  - Information properly provided to the former employee by third-party sources, such as clients
- Courts may also analyze how employers seek to enforce confidentiality clauses by, for example, demanding the return of all information and materials received, encountered, or learned during the employment in determining whether the confidentiality clause operates as a de facto noncompete.

Bus. & Prof. Code § 16600

- Except as provided in this chapter, every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void.

New B&P Code § 16600.1 – Broadens Protections; Notice (effective Jan. 1)

- Unlawful to include a noncompete clause in an employment contract or to require an employee to enter a noncompete agreement, that does not satisfy statutory exception.
- Section 16600 not limited to contracts where the person being restrained from engaging in a lawful profession, trade, or business is a party to the contract.
- Must provide notice to current and former employees who were employed *after January 1, 2022*, whose contracts include a noncompete clause or who were required to enter a void noncompete agreement.
  - Notice must notify the employee that the noncompete clause or noncompete agreement is void.
  - Notice shall be in the form of a written *individualized* communication to the employee or former employee. The law does not define "individualized" or specify the amount of detail that is to be provided.
  - Notice must be provided by February 14, 2024.
- Violation of new law constitutes an act of unfair competition. Unfair competition is addressed through declaratory judgments, restitution (which can include attorneys' fees), and injunctive relief.
- The law does not define what a noncompete clause is so there is ambiguity, but § 16600 is also being amended to state: "This section shall be read broadly, in accordance with *Edwards v. Arthur Andersen LLP* (2008) 44 Cal.4th 937, to void the application of any noncompete agreement in an employment context, or any noncompete clause in an employment contract, **<u>no matter how narrowly tailored</u>**, that does not satisfy an exception in this chapter."

New B&P Code § 16600.5 – Private Right of Action (effective Jan. 1)

- Employer cannot enter into contract that is void under § 16600. A contract is void regardless of where or when the unenforceable contract was signed.
- Employer/former employer cannot attempt to enforce void contract regardless of whether the contract was signed and the employment was maintained outside of California.
- Employer commits a civil violation if it enters into a void contract or attempts to enforce a void contract.
- Employee/former employee/prospective employee may bring a private action to enforce this chapter for injunctive relief and actual damages and shall be entitled to recover reasonable attorney's fees and costs. Further, there is now a possibility for employees to bring PAGA or class actions.
- *NOTE* – Case law since late 2018 has held that nonsolicitation of employees' provisions violate § 16600. The CA Supreme Court is yet to rule on the issue, but we do not anticipate the Supreme Court changing course.

Only Three Statutory Exceptions to B&P Code § 16600

1. Sale of Business
2. Dissolution/Termination of LLC Interest
3. Dissolution of/Disassociation with Partnership

Sale of Business in Corporation – B&P Code § 16601

- Any person who sells the *goodwill* of a business, or any owner of a business entity selling or otherwise disposing of *all* of his or her ownership interest in the business entity, or any owner of a business entity that sells
  - (a) all or substantially all of its operating assets together with the goodwill of the business entity,
  - (b) all or substantially all of the operating assets of a division or a subsidiary of the business entity together with the goodwill of that division or subsidiary, or
  - (c) all of the ownership interest of any subsidiary,

may agree with the buyer to refrain from carrying on a similar business within a specified geographic area in which the business so sold, or that of the business entity, division, or subsidiary has been carried on, so long as the buyer, or any person deriving title to the goodwill or ownership interest from the buyer, carries on a like business therein.

Termination of LLC Interest – B&P Code § 16602.5

- Any member may, *upon or in anticipation of a dissolution of, or the termination of his or her interest* in, a limited liability company (including a series of a limited liability company formed under the laws of a jurisdiction recognizing such a series), agree that he or she or it will not carry on a similar business within a specified geographic area where the limited liability company business has been transacted, so long as any other member of the limited liability company, or any person deriving title to the business or its goodwill from any such other member of the limited liability company, carries on a like business therein.

Dissolution of/Disassociation from Partnership – B&P Code § 16602

- (a) Any partner may, upon or in anticipation of any of the circumstances described in subdivision (b), agree that he or she will not carry on a similar business within a specified geographic area where the partnership business has been transacted, so long as any other member of the partnership, or any person deriving title to the business or its goodwill from any such other member of the partnership, carries on a like business therein.
- (b) Subdivision (a) applies to either of the following circumstances:
  - (1) A dissolution of the partnership.
  - (2) Dissociation of the partner from the partnership.

Health and Welfare Plan Fiduciary Committee

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H&W Plan Fiduciary Committee

- The fiduciary standards under ERISA apply to all employee benefit plans
  - Duty of loyalty
  - Duty of prudence
  - Duty to administer the plan in accordance with its written terms
- Most plan sponsors have an established fiduciary committee dedicated to governance of its retirement plans
  - Retirement plans have been the subject of regulatory guidance and enforcement activity
  - Retirement plans have been the subject of significant litigation over the years
  - Perceived higher stakes on the retirement side; investments and plan assets

H&W Plan Fiduciary Committee

- Growing litigation risk with H&W Plan
  - COBRA litigation continues
  - Price transparency
  - Fee transparency
    - 408(b)(2) disclosures – brokers and consultants must disclose direct and indirect compensation
  - Gag clause attestation
  - Mental Health Parity
  - Cybersecurity/Data privacy
  - Claims and appeals

H&W Plan Fiduciary Committee

- Next Steps
  - Establish a fiduciary committee for H&W
    - Create a charter or expand an existing one to set forth responsibilities for the committee including:
      - Monitoring compliance with laws
      - Monitoring fee and price transparency
      - Monitoring TPAs, including performance guarantees, rebates and independent claims audits
      - Establishing a documented prudent process

Special Financial Assistance Program: Highlights

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Special Financial Assistance (SFA)

- SFA Program was enacted as part of the American Rescue Plan Act of 2021. The program provides funding to severely underfunded multiemployer pension plans in an amount sufficient for them to remain solvent until 2051.
- As of January 2024, PBGC has approved about $53.5 billion in SFA to plans that cover more than 967K participants and beneficiaries.
- PBGC has approved 104 applications and is currently reviewing 15 applications.
- Only one application has been denied (because it was previously terminated). All other applications have been approved or withdrawn (based on the need to change an assumption, rather than eligibility).
- PBGC has recently applied increased scrutiny on plans over their death audit procedures and their contribution base unit assumptions.

SFA Application Update (as of January 5, 2024)

Priority Group	Classification	PBGC Estimated Plans	Approved Applications	Plans In Review	SFA Amount Requested in Application	Final SFA Amount Approved Including Interest and FA Loan Repayments	SFA Under Review
1	Insolvent	30	46	2	$4,317,095,590	$4,522,621,618	$225,225,547
2	Nearing Insolvency*	5	13	0	$3,783,497,931	$3,779,001,192	$0
	Implemented MPRA Cuts	18	25	0	$3,786,377,070	$3,987,614,553	$0
3	Central States	1	1	0	$34,965,401,436	$35,764,910,110	$0
4	Nearing Insolvency*	0	0	0	$0	$0	$0
5	Looming Insolvency**	16	11	1	$1,776,930,383	$1,826,199,386	$38,100,920
6	Large Plans	14	3	3	$3,226,308,937	$3,299,196,090	$5,608,533,029
No Priority	Non-Priority Plans	218	5	11	$382,157,219	$392,294,567	$1,143,274,775
Totals	All Eligible Plans	284	71	19	$55,880,292,547	$53,571,837,516	$7,015,134,271

SFA Challenges

SFA Program Application Process

- When the SFA Program began, PBGC accepted applications from certain high-priority plans. Now, priority windows have closed. Nonpriority groups may apply via a waitlist and metered application process.
- The SFA application review process is extensive and must be completed within a short review time frame (120 days within filing).
- PBGC does not have the capacity to accept new applications en masse, so they created a waiting list.
- Plans will be picked, in order, from the waiting list. A plan has seven calendar days to submit an application.
- There are 89 plans on the waiting list.

SFA Program Review

- A plan must submit detailed historical, actuarial, and financial information.
- PBGC reviews the information and often seeks additional information from the plan.
- Then the application will be approved or the plan will have an opportunity to withdraw and revise certain assumptions—or be denied.

PBGC's Inspector General Found SFA Overpayments to Deceased Participants

PBGC's OIG found that the agency did not perform an independent death audit to cross-check deceased participants that the Central States Pension Plan reported in its application for SFA.

This resulted in an overpayment to the Central States Pension Fund of over $127 million.

PBGC is finalizing its internal processes for resolving and closing out death audit results for current and future SFA applicants.

Ongoing Compliance and Investigations

- Any plan that receives SFA has to certify its compliance with PBGC's regulations on an annual basis.
- Plans in receipt of SFA funds can invest up to 33% of their SFA-assets in return-seeking assets (e.g., publicly traded common stock and equity funds that invest primarily in public shares); with the remaining 67 percent restricted to high-quality (investment grade) fixed income investments.
- Several plans in receipt of SFA funds have been or are being audited by the DOL.

Withdrawal Liability Considerations

Withdrawal Liability and How It May Be Triggered

- An employer who ceases to contribute to a multiemployer pension plan must pay a proportionate share of the plan's unfunded vested liabilities, even where the employer has paid all contributions required to be made by it under the applicable CBA.
- A "complete" withdrawal generally occurs when an employer either:
  - permanently ceases to have an obligation to contribute to the plan (e.g., CBA expires)
  - permanently ceases the business activity that gave rise to its participation in the plan (e.g., upon the employer's sale of the business in an asset deal)
- A "partial" withdrawal occurs when there is either:
  - a 70% or more decline in historical contribution base units over three consecutive years
  - a cessation of an obligation to contribute for fewer than all CBAs, but continues to perform work in the jurisdiction of the CBA or at the same facility; in either case, where the work is of the type for which contributions were previously required
- A "mass withdrawal" can occur upon withdrawal of all or substantially all employers from the plan
  - employers who withdraw within three years of mass withdrawal are presumed to have withdrawn as part of the mass withdrawal

Special Withdrawal Liability Rules for Pension Funds That Receive SFA

- Under the PBGC's final regulation related to the SFA program, plans that receive SFA must use a phase-in approach when including SFA assets in withdrawal liability calculations
  - For example, if a plan projects that SFA will last for 20 years, then 1/20th of the SFA amount will be included in the plan's assets for withdrawal liability purposes in each year over the 20-year period starting with the year in which the plan receives the SFA
- Plans receiving SFA must also use mass withdrawal liability discount rates when calculating withdrawal liability for at least 10 years, or until the plan no longer holds any SFA assets, if later
  - These rates were very low when the final regulation was issued (e.g., in July 2022, the applicable rate was ~3%), but is now ~5%
  - Current PBGC mass withdrawal discount rates are slightly lower than the effective rates that many funds use when calculating withdrawal liability, but higher than the effective rate that a few funds (most notably Central States) were using to calculate withdrawal liability

Interplay Between SFA, Interest Rates & Withdrawal Liability

While the requirement to use PBGC interest rates for withdrawal liability purposes may increase withdrawal liability for a plan that currently uses a higher funding rate interest assumption (typically in the 6.5%–7.5% range) or a method of blending the current PBGC rates and the plan's funding rate (the so-called "Segal blend" method), this increase will be offset—either partially or fully—by the amount of the SFA.

Some plans already use the mass withdrawal interest rate assumption to calculate withdrawal liability. For plans that already use the mass withdrawal rate, an employer's total withdrawal liability exposure may decrease after the plan's receipt of SFA, though it is also possible that an employer's "effective" withdrawal liability may stay the same if the amount of the reduction will not be paid off under the employer's 20-year payment schedule.

The PBGC has proposed a separate rule of general applicability under section 4213(a) of ERISA to prescribe actuarial assumptions that may be used by a plan actuary in determining an employer's withdrawal liability. The lawfulness of the Segal blend and other interest rate assumptions that diverge from a plan's funding rate assumption has been litigated heavily over the last several years. It is possible that a generally applicable PBGC rule will at least attempt to settle the issue with respect to future withdrawals.

Retirement Plan Update: SECURE 2.0 Update and Litigation Developments

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SECURE and SECURE 2.0 – Proposed Regulations for Long-Term Part-Time Employees

- In November 2023, the IRS issued proposed regulations explaining how to apply the long-term part-time employee (LTPE) rules of SECURE 1.0 and SECURE 2.0.
- As a brief refresher:
  - SECURE 1.0 established the LTPE rules that require employers to extend 401(k) plan participation to employees completing 500 or more hours of service in three consecutive years.
  - SECURE 2.0 modified the LTPE rules to decrease the eligibility period from "three" to "two" consecutive years and also expanded the rules to apply to 403(b) plans.
  - The LTPE rules only extend participation for purposes of making elective deferrals and do not require employers to provide matching or other employer contributions to LTPEs.
  - While facially straightforward, the LTPE rules raise a host of technical and administrative issues and questions.
  - SECURE 1.0 rules effective January 1, 2024, and SECURE 2.0 rules effective January 1, 2025.

Long-Term Part-time Employees cont'd

- In many respects, the proposed regulations confirm anticipated service-counting rules and concepts for LTPEs (e.g., measuring periods, entry dates, etc.)
- Other key points from the proposed regulations include:
  - LTPEs include only those employees who are plan participants solely by virtue of satisfying the LTPE rules
  - Bona fide class-based eligibility exclusions continue to be permissible
  - LTPE rules do not apply to plans utilizing the "elapsed time" method of counting service
  - How to qualify for nondiscrimination and top-heavy testing relief for LTPEs
  - How to count vesting service for LTPEs
- Plan sponsors with LTPEs should be working with their advisors and providers to understand and implement the LTPE rules

SECURE 2.0 – Grab-Bag Guidance

- On December 20, 2023, the IRS issued Notice 2024-2, which contains guidance in the form of Q&As on a range of SECURE 2.0 issues and topics, including:
  - Automatic enrollment (Section 101).
  - Start-up credits for small employers (Section 102).
  - Military spouse eligibility credit for small employers (Section 112).
  - Financial incentives for contributing to a plan (Section 113).
  - SIMPLE plan contribution limit (Section 117).
  - Terminal illness exception for early-distribution penalty (Section 326).
  - Mid-year replacement of SIMPLE retirement accounts with a safe harbor 401(k) plan (Section 332).
  - Cash balance plan clarifications (Section 348).
  - Employee elective deferral failures (Section 350).
  - Plan amendment provisions (Section 501).
  - SIMPLE and SEP Roth IRAs (Section 601).
  - Treatment of employer contributions or nonelective contributions as Roth (Section 604).

SECURE 2.0 Grab-Bag Guidance

- SECURE 2.0 Automatic Enrollment: Any plan established on or after the December 29, 2022 enactment of SECURE 2.0 must include automatic enrollment and escalation features effective for plan years beginning after January 1, 2025
- IRS notice provides guidance on:
  - Whether a plan is a "pre-enactment" or "post-enactment" plan for these purposes
  - How to apply the rules to "pre-enactment" and "post-enactment" plans that are merged together (either as a result of an M&A transaction or otherwise)
  - How to apply the rules to multiple employer plans and employers who stop and start participation in a multiple employer plan

SECURE 2.0 Grab-Bag Guidance

- SECURE 2.0 Optional Roth Treatment for Employer Contributions: SECURE 2.0 permits employers to offer employees the opportunity to elect Roth treatment of employer matching and nonelective contributions
- The IRS notice provides helpful guidance clarifying the tax treatment and reporting of such optional Roth contributions
  - Not subject to income tax withholding (though employees may need to increase withholding or make estimated payments)
  - Not subject to FICA or FUTA
  - Reported on Form 1099-R in the same manner as an in-plan Roth conversion
  - Optional treatment only available for fully vested employer contributions

Retirement Plan Litigation Update

- 401(k) and 403(b) plan fee and expense and investment performance cases continue to be common, including:
  - Cases alleging excessive investment and/or recordkeeping fees
  - Cases focused on the performance and expenses of target date fund offerings
- Several new cases filed against large companies/plans alleging that the plans improperly used forfeitures to reduce employer contributions rather than to pay plan expenses
  - Cases make novel claims that contradict longstanding practices and IRS precedent explicitly permitting the use of forfeitures to reduce employer contributions
- New tranche of actuarial factor cases filed in 2023 involving pension plans
  - Original tranche of cases filed against large pension plans in 2018/2019 alleged that the plans used outdated actuarial factors (particularly outdated mortality tables) for purposes of calculating optional forms of payment that understated participants' benefits
  - New tranche of cases filed by new plaintiffs' firm makes similar claims

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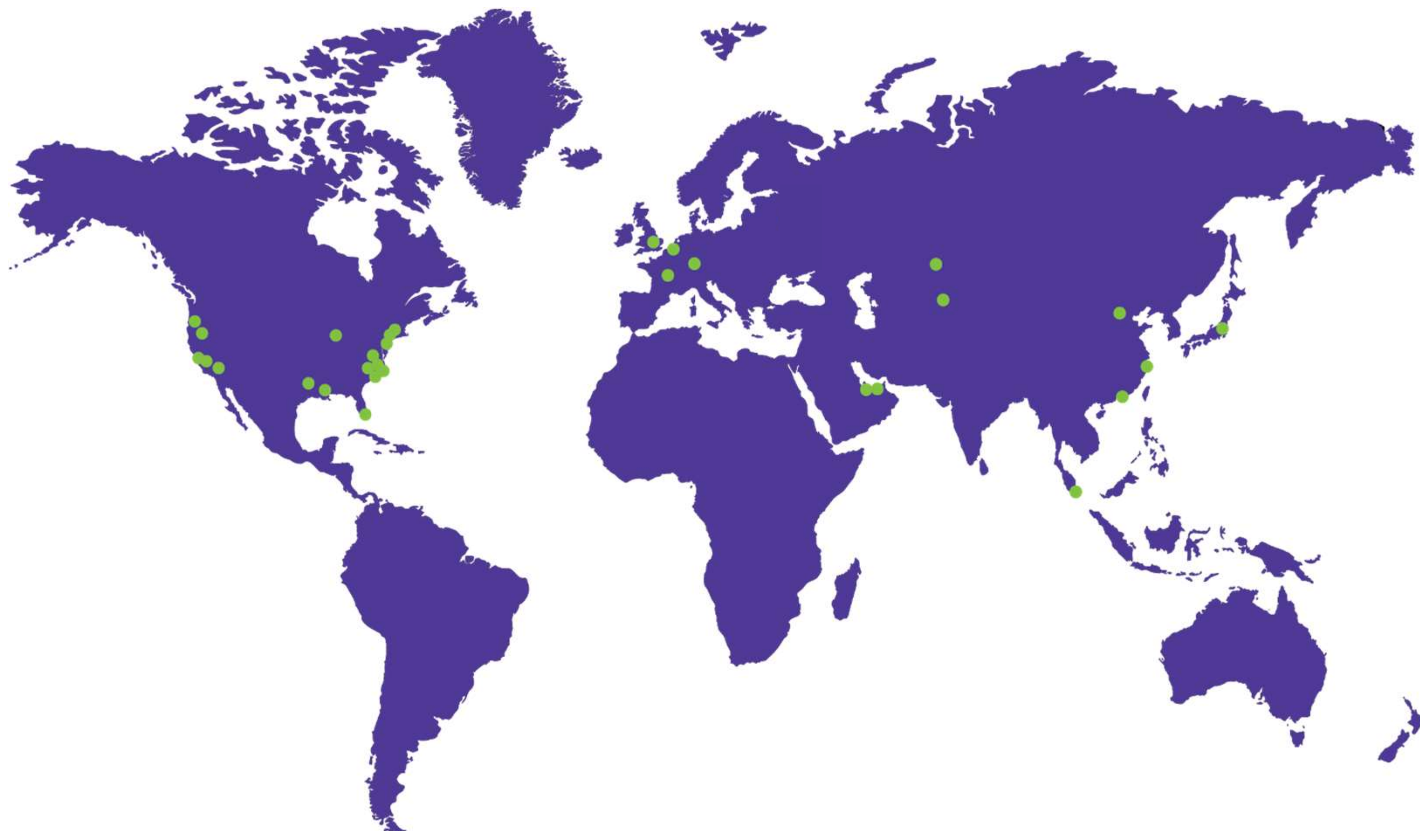

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