Willis

FOCUS

On Benefits

In This Issue

Benefits Keep Pace with Wages

A survey released at the end of 2004 by the Bureau of Labor Statistics reveals that wages grew nearly as much as benefits. Benefits increased 11 cents, or 1.6 percent, to $6.80 per hour. Total compensation rose 1.5 percent, to $16.96 per hour.

The report also noted the following:

- Health insurance costs increased 5.4 percent from third quarter in 2003. (By most reports, overall medical cost inflation continues at double digit rates. This figure probably demonstrates cost shifting by employers rather than a flattening of medical cost inflation.)

- Retirement and savings plan costs increased 3.7 percent to 85 cents per hour. This number is 25 percent higher than last year.

- Benefits account for 28.6 percent of overall compensation. This is almost a full percentage point above last year's numbers.

If you want to read the full report, it can be found at www.bls.gov/news.release/pdf/ecec.pdf.

COBRA: Gross Misconduct

An employer may deny the right to COBRA coverage for reasons of "gross misconduct." Gross misconduct is largely left undefined, so an employer's determination must be informed by court cases. Generally, gross misconduct consists of willful activities that jeopardize an employer's business operations, employee criminal behavior, fraud, or activities that violate an employer's written policies.

March 2005
www.willis.com

The following case explores this issue. In *Richard v. Industrial Commercial Electrical Corporation*, 2004 U.S. Dist. LEXIS 20024 (D. Mass. 2004), Donald Richard was fired for gross misconduct and was denied COBRA continuation coverage.

Richard reported to the president of the company. During an office move, the company president asked Richard to take "personal property" from the office to the president's new apartment. Following his boss' direction, Richard moved the items to the president's apartment. The president asked Richard not to disclose the location of the apartment; he wanted to keep its location private because of marital problems.

Later, in a power struggle between individuals at the company, Richard was accused of stealing the goods that he had delivered to the president's apartment. When Richard denied stealing the goods, the company treasurer demanded that Richard reveal the address or directions to the president's apartment. When Richard refused to disclose the location of the apartment, he was fired for gross misconduct and was not offered COBRA continuation coverage.

In this case, the court considered a state Supreme Judicial Court's definition: "Willed and intentional conduct that is flagrant and extreme and out of all measure; beyond allowance; not to be excused, and … shameful." Additionally, the court reasoned that gross misconduct would have to constitute more than an error of judgment. Ultimately, the company failed to prove that Richard had been told he was to take orders from the treasurer instead of from the president — to whom he had reported for 12 years. Finally, considering the fact that Richard reasonably believed that he was performing work on behalf of the company (as opposed to the company president) and since he did not intend to harm the company, the court found in his favor. The company was ordered to permit him to elect COBRA under the company health plan.

Although the decision in this case is not binding on other jurisdictions, some courts may find it persuasive when considering the intentions of an employee and the dynamics of reporting to an individual who orders questionable activity.

Canadian Drugs: Less Savings Than Projected

Reports are surfacing saying Canadian drug suppliers are raising their prices — offsetting any price advantage. Moreover, many drug companies have stopped supplying the Internet pharmacies. A growing number of Internet pharmacies are being forced to go to storefront pharmacies for their supplies. The additional costs, ranging from seven to 15 percent, are passed to the consumer. Canadian legislators are trying to require the patient to actually be seen by a Canadian physician — instead of just getting the physician to countersign the U.S. prescriptions. These factors should dampen the enthusiasm for purchasing drugs from Canada: which is not legal or deemed safe by the FDA.

Benefits of Offering Benefit Plans

Employers reluctantly take in stride annual benefit plan cost increases. Somewhat reducing the pain, calculating the monetary benefits of offering benefit plans is a special treat. *The Wall Street Journal*

published a list of ten positive aspects of providing benefits to employees. Some of those are listed below.

Low-Cost Retiree Health Coverage – Contrary to media reports, carefully planned retiree medical coverage can contain health care costs.

When retiree medical coverage encourages early retirement (and assuming that the positions vacated will not be filled), providing it is only a continuation of the benefits that were in place. A company can establish contribution limits for retiree medical coverage so that, once that limit is reached, the rest of the costs are passed on to the retirees. As more and more of the costs are passed on to retirees, presumably the total number of retiree medical recipients will get smaller as the expense outstrips a retiree's ability to pay for coverage. Of course, passing on increased costs to retirees could also have the negative impact of keeping only the sickest retirees in the health plan.

Be sure to consider Health Reimbursement Accounts (HRAs) or, to a lesser extent, Health Savings Accounts as a retiree option. With an HRA the employer can determine in advance precisely the amount it will spend on retiree medical coverage. Plus the HRA is a tax efficient vehicle for retirees.

Cafeteria Plan Savings – Employers utilizing this tax vehicle will save money on reduced amounts that are subject to Medicare and Social Security withholding. Amounts that are reduced to pay for benefits through a cafeteria plan generate FICA and FUTA savings for both the employer and employee.

Government Subsidy of Prescription Drugs – Beginning in 2006, changes in the Medicare laws will result in a 28 percent government subsidy of retiree prescription spending between $250 and $1,330. This subsidy makes it easier for employers to afford to offer retiree prescription drug coverage.

Pension plans – Approximately 66 percent of the companies in Standard & Poor's 500-stock index still maintain pension funds. First, an employer can access the pension assets in order to pay administrative expenses (consultants, actuaries, investment managers, etc.) related to the provision of the benefit. Secondly, a plan sponsor can use pension funds to pay for retiree medical coverage. Although both of these options must be watched carefully to avoid depletion of the plan's assets, the ability to use these funds for plan expenses makes these benefits much more affordable. In fact, SBC Communications has been in the news lately for its decision to reintroduce a traditional pension plan for some of its employees.

Lump-Sum Pension Payments – Although generous benefits can make it easier to fill positions and hire talent, good benefits can also be used as a retirement carrot for aging employees. Lump-sum pension payments can generally save employers between 20 to 30 percent in addition to reducing the administrative costs of monitoring and communicating with pension recipients. When lump-sum pensions are offered, employers should remember that they can provide employees with a pension choice that will save the employer money. Although it is illegal to cut a pension benefit that has been earned, it is not illegal to offer employees a choice between monthly pension funds and a lump-sum distribution.

Pension Investment Gains – Due to investment choices, downsizing, and changes in pension benefits in general, some employers have found their pension plan costs have decreased.

401(k) Contribution Savings – The benefits of pre-tax employee contributions are clear, but when employees contribute to a 401(k), employers also directly benefit through savings realized on payroll taxes.

Recruiting Tool – Many employers have found that providing richer benefits is significantly cheaper than offering higher salaries — and more effective.

FMLA Scamming?

The Family and Medical Leave Act of 1993 was created with the idea of providing job-protected leave for the employee's or a family member's health conditions that necessitated the employee's leave of absence.

Although employees are grateful for FMLA leave, worker absence is leaving employers cold. Complaints about FMLA leave are increasing. The Labor Department says that complaints have increased from 2,790 in 2001 to 3,565 in 2003. Employers, afraid of denying leave that may qualify for FMLA leave, are granting questionable leaves with poor documentation despite the fact that such leaves often cause severe work interruption. One client told us about an employee who regularly pulled into the parking lot on Friday mornings. With a ski boat behind a pickup truck, he would walk into the HR office to fill out the paperwork for FMLA leave. The same worker would come back to work after a long weekend; continuing this pattern throughout the summer! (FMLA contains rules which safeguard employers by allowing them to require evidence of the basis for a leave request before authorizing time off. Unfortunately, some employers worry about provoking workers if they require such evidence.)

One group, the FMLA Technical Corrections Coalition, is pushing Congress to create a firm definition for "serious health condition" and to put limits on intermittent leave under FMLA. For many employers, intermittent leave is taken at the most inconvenient times. In fact, the DOL reports that 27 percent of FMLA leave is taken intermittently, which creates morale problems for the employees remaining on the job.

The *Wall Street Journal* reports that employers feel trapped and often grant FMLA just to avoid a legal challenge. In 1995 one unfortunate employer questioned the need for FMLA leave when an employee took leave for an ingrown toenail and subsequent infection; the employer and the employee later settled the case. The fact remains that employers are feeling pressured by employees "who work the system" to their advantage, touting a serious health condition and using intermittent leave — even taken in hours, not days. Even if such leave is justified, employers must also deal with the recordkeeping headaches of this system.

Health Care Spending Trends Slowing

It has been seven years since health care spending has slowed, but some good news appears to have arrived. The 2003 figures on health care expenditure rates were published by the Centers for Medicare and Medicaid Services (CMS) and indicate that, while health care costs are increasing, the increases were noticeably lower than past years. For instance, health care expenditures grew by 7.7 percent as opposed

to a 9.3 percent growth in 2002. This deceleration in health care spending in 2003 is mainly attributed to reduced Medicare and Medicaid spending, but private sector health care spending also slowed.

Perhaps most surprising were CMS statistics indicating that prescription health care spending slowed more drastically than any other sector of health care costs. This after three prior consecutive years of slowed consumer prescription drug spending. CMS records indicate that prescription drug spending for 2003 rose "only" 10.7 percent as opposed to rising nearly 15 percent in 2002.

Although the news on health care spending trends is encouraging, a study from Harvard's law and medical schools indicates that 46.2 percent of all personal bankruptcies were due to serious illness and medical bills. While most of the individuals who filed bankruptcy were covered by medical insurance, the cost of medical care for catastrophic illness was a major factor in driving households to seek protection from creditors.

Pregnant Workers Report Growing Discrimination

Where will Congress next turn its attention? Some experts predict legislators will beef up protections for women who work during pregnancy. Evidence of the need for reform is being widely reported by the media. *USA Today* reports that despite birth rate declines, more and more women are filing discrimination complaints against employers because of the way they were treated while pregnant. Although sexual harassment and discrimination claims have risen, pregnancy discrimination is the largest segment of discrimination complaints in recent years. Wal-Mart, Hooters, and Cincinnati Bell have all faced pregnancy discrimination lawsuits. Other firms could face similar cases in court as they discriminate against pregnant women in entry-level positions and executive suites.

According to the Department of Labor, about 47 percent of the workforce is made up of women of child-bearing age; and figures show that many of them are waiting until they are older to have children. Pregnancy discrimination cases are on the rise and employers can expect higher costs associated with those lawsuits. The U.S. Equal Employment Opportunity Commission reports that settlements reached $12.4 million in 2003, up from $3.7 million in 1992. Experts point out that because these women are working longer while pregnant, myths about pregnancy are affecting employment as well as other staffing choices, particularly as companies begin to feel pressured to produce more and more.

Issue Spotlight: COBRA's Small Employer Definition

An employer with fewer than 20 employees in the last calendar year is exempt from federal COBRA requirements for the current year. Because a small employer's COBRA obligations for the current year are determined by looking back to the previous year, a small employer usually will have a fairly long lead time to begin complying with COBRA. For example, an employer that grows from 19 employees in 2005 to 22 employees in 2006, will have until January 1, 2007 to begin complying with COBRA.

The IRS recently issued a Revenue Ruling that explains how to apply this look-back rule when a small employer gains employees through acquisition. The IRS confirmed that it will look only at the acquiring company's workforce during the previous year. So, the acquiring company will remain a small employer

at least until the beginning of the next year. The IRS will apply the look-back rule in this way for all acquisitions except stock acquisitions. (In a stock acquisition, the capital stock or other equity interest of the acquired company, is purchased.)

If a small employer makes a stock acquisition, employees of the acquired company will be treated as employed during the calendar year *before* the acquisition. Such an employer will not have the lead time it otherwise would have to become compliant with COBRA.

Small employer status does not prevent inheriting the COBRA responsibilities of the company being acquired. According to the Revenue Ruling, if the acquired company was subject to COBRA at the time of the transaction — and the small employer buyer is a successor for purposes of COBRA — then the small employer will be responsible for providing COBRA coverage to the selling company's employees and existing qualified beneficiaries. This occurs in all situations in which the buying employer is a successor and the acquired company was subject to COBRA.

U.S. Benefit Office Locations

Anchorage, AK
(907) 562-2266

Atlanta, GA
(404) 224-5000

Austin, TX
(800) 861-9851

Baltimore, MD
(410) 527-1200

Bethesda, MD
(301)530-5050

Birmingham, AL
(205) 871-3871

Boston, MA
(617) 437-6900

Cary, NC
(919) 459-3000

Charlotte, NC
(704) 376-9161

Chicago, IL
(312) 621-4700

Cleveland, OH
(216) 861-9100

Columbus, OH
(614) 766-8900

Dallas, TX
(972) 385-9800

Denver, CO
(720) 932-8137

Detroit, MI
(248) 735-7580

Eugene, OR
(541) 687-2222

Florham Park, NJ
(973) 410-1022

Ft. Worth, TX
(817) 335-2115

Grand Rapids, MI
(616) 954-7829

Greenville, SC
(864) 232-9999

Houston, TX
(713) 625-1023

Jacksonville, FL
(904) 355-4600

Knoxville, TN
(865) 588-8101

Lake Mary, FL
(407) 805-3005

Lexington, KY
(859) 223-1925

Long Island, NY
(516) 941-0260

Los Angeles, CA
(213) 607-6300

Louisville, KY
(502) 499-1891

Memphis, TN
(901) 818-3263

Miami, FL
(305) 373-8761

Milwaukee, WI
(414) 271-9800

Minneapolis, MN
(763) 302-7100

Mobile, AL
(251) 433-0441

Montgomery, AL
(334) 264-8282

Mountain View, CA
(650) 944-7000

Naples, FL
(239) 514-2542

Nashville, TN
(615) 872-3700

New Orleans, LA
(504) 581-6151

New York, NY
(212) 344-8888

Orange County, CA
(714) 953-9521

Philadelphia, PA
(610) 964-8700

Phoenix, AZ
(602) 787-6000

Pittsburgh, PA
(412) 586-1400

Plainview, NY
(516) 941-0260

Portland, OR
(503) 224-4155

Raleigh, NC
(919) 459-3000

Rochester, NH
(603) 332-5800

Roswell, NM
(505) 317-3397

St. Louis, MO
(314) 721-8400

San Diego, CA
(858) 455-4888

San Francisco, CA
(415) 981-0600

San Juan, PR
(787) 756-5880

Seattle, WA
(206) 386-7400

Tampa, FL
(813) 281-2095

Washington, DC
(301) 530-5050

Wilmington, DE
(302) 477-9640

Other Willis Locations:

Willis has offices in more than 20 other U.S. cities and in 73 countries around the world, with a total of 260 offices worldwide.

FOCUS is produced by Legal & Research Group of Willis: willis.focusonbenefits@willis.com or 877-4WILLIS (toll-free). *FOCUS* is not intended to provide legal advice. Please consult your attorney regarding issues raised in this publication. Willis publications appear on the internet at: www.focusonbenefits.com.