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Employment Law Update

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HIPAA Requires More of Employers and Their Health Plans

by Deborah K. Hepler

You may have been asked recently to sign various documents from your employee benefit plan's third party administrator ("TPA"). Those documents may impose duties on you that federal law requires of any employer who participates in the administration of a benefit plan. If you did not change your internal policies and procedures, you could already be in violation of those documents.

Many employers use a TPA to handle the administrative details of their employee benefit plans. If the plan needs amendments, a different coverage package, or changes in employee contribution levels, the TPA handles the process. Most of the time, this strategy is successful.

However, the Health Insurance Portability and Accountability Act ("HIPAA") is different. Although it is the plan that HIPAA covers, plans are treated as a component within the employer's business. Therefore, the employer is responsible for making sure the plan meets its HIPAA obligations. That flurry of paperwork is just the beginning.

Why is compliance important? First, it is mandatory. Second, it can increase employee confidence in your company's benefit plans. Third, noncompliance can be costly, with civil fines (up to $25,000) and criminal penalties (up to $250,000 or 10 years in prison) for violations. Fourth, courts already use the HIPAA privacy rule as the appropriate standard of care in lawsuits by individuals for misuse of their health information.

By signing and distributing those HIPAA documents, you have taken the first step toward compliance. What comes next depends on your level of involvement with plan administration.

Namely, if the plan or the TPA shares any protected health information ("PHI") with the employer, HIPAA requires that the plan documents be amended. For health plans, PHI means individually identifiable information that:

(a) is created by or received from a health care provider or health plan; and

(b) relates to the past, present, or future physical or mental health or condition of an individual; the provision of health care to an individual; or the past, present, or future payment for the provision of health care to an individual.

In addition to amending the plan, employers who receive PHI must notify their employees that they will have access to plan participants' PHI. This required notification is done through a notice of privacy practices ("Notice"), which your TPA may have asked you to distribute to plan participants. The Notice imposes obligations on you and describes rights your employees have regarding their PHI.

HIPAA defines PHI broadly. The simple act of reimbursing an employee for health care costs through a self-funded or flexible spending plan may create PHI. Thus, HIPAA expands the class of employees who are considered to have access to PHI. In doing so, it imposes a duty on employers to adopt policies for and provide training to those employees to comply with HIPAA.

One of the most significant HIPAA obligations is to establish "adequate separation" between plan administration and employment functions. At the very least, the employer should: a) designate those employees who may access the PHI; b) restrict access to and use of PHI to "plan administration functions," limited to the minimum necessary to perform the function; and c) establish an effective mechanism for dealing with non-compliance by the designated employees.

Any employer who both sponsors and administers a group health plan may be subject to all of the HIPAA standards, including the Privacy Rule, Security Rule, and the Electronic Transaction Standards. Read your plan documents carefully. You may be surprised to learn that you are both the plan sponsor and the plan administrator of your employee benefit plan. Numerous administrative requirements await an employer who wears both of these hats.

HIPAA is not just for doctors and hospitals. It applies to group health plans, and possibly to the employer sponsoring the plans. Compliance is mandatory and noncompliance can be costly. Consult your legal counsel to make sure you and your plans are meeting all relevant HIPAA standards. ♦

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Foreseeability Under The Workers' Adjustment and Retraining Notification ("WARN") Act

by John H. Daerr

The WARN Act applies to employers with 100 or more employees and provides a variety of protections to employees during a plant closing or mass layoff. If the closing or layoff affects 50 or more employees, the employer must give at least 60 days advance written notice to the affected employees, their representatives, and appropriate local government officials. Failure to give this notice could lead to liability for back pay and benefits for the entire 60 days, unless a business emergency exists.

Two recent court decisions illustrate some of the circumstances that give rise to a duty to give 60 days written notice to affected employees. The courts make it clear that an employer should make an honest and unbiased foreseeability assessment before deciding if it must give the WARN notice.

Roquet v. Arthur Andersen, LLP

In June 2001, Arthur Andersen was embroiled in an SEC investigation relating to one of its clients, Waste Management Inc. In that context, the accounting firm agreed to accept a permanent injunction preventing it from violating the Securities Exchange Act of 1934 and pay a $7 million fine. A few months later, the public learned the SEC was also investigating Arthur Andersen in connection with its role in assisting Enron. Almost immediately, experts were of the opinion that Arthur Andersen would not be able to survive this latest investigation.

However, in early 2002, Arthur Andersen was working closely with the SEC and the Department of Justice ("DOJ") to resolve these new issues and Andersen management believed that no criminal charges would be filed and no layoffs would be required. Andersen was mistaken. The DOJ did in fact issue indictments against Andersen on March 14, 2002. Once the indictments were made public, Andersen began losing clients at a rapid pace. By the end of March, mass layoffs became necessary. Andersen did not give the affected employees 60 days advance written notice before the layoffs began.

Eventually, a class action lawsuit was initiated against Andersen by its former employees. They accused Andersen of knowing as early as October 2001 that financial problems were escalating and that the company might be linked to the Enron scandal. The former employees claimed they should have been given the 60 day WARN act notice before any layoffs occurred.

The court disagreed. As the court explained, the undisputed evidence showed that prior to the indictments, Andersen had lost only a small portion of its business and was operating within its normal business cycle. Further, the court noted that Andersen had been working closely with the DOJ in an effort to avoid criminal prosecution.

> ***"An employer should make an honest and unbiased foreseeability assessment before deciding if it must give the WARN notice."***

Although acknowledging that Andersen was aware that a criminal indictment could drive away clients, the court determined there was no way for Andersen to have predicted when or if the indictment would actually occur. It came as a surprise and was "completely beyond the control of Anderson." As such, Anderson avoided liability. *Roquet v. Arthur Andersen, LLP*, 2004 U.S. Dist. LEXIS 5150 (March 22, 2004 N.D. Ill.).

Pena v. American Meat Packing Corp.

A few days after the decision in the Arthur Andersen case, the Seventh Circuit held that determining if information known to an employer triggered its WARN Act duty depends on how a reasonable, similarly-situated employer might have reacted to the same business circumstances. *Pena v. American Meat Packing Corp.*, 362 F.3d 418 (7th Cir. 2004).

The American Meat Packing Corporation had acquired a hog processing plant in 1998. Five full-time USDA inspectors worked at the plant to monitor sanitary conditions. In 2001, these inspectors issued at least 31 citations against the plant for its failure to comply with USDA standards. On occasion, the inspectors even withheld their inspections, which in turn halted production and essentially blocked the shipment of meat. American attempted to comply with the USDA standards, but in early November 2001 the inspectors issued four new citations, withheld inspections, and once again blocked production.

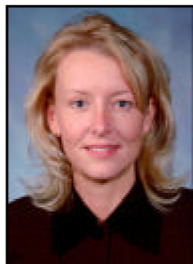
Eventually, the USDA withdrew its inspectors from the plant, blocking the shipment of 1 million pounds of meat. Due to the costs associated with this regulatory action, and the expenses of necessary repairs to comply with the USDA standards, the company decided to close the plant.

The employees filed suit, claiming that the president of American knew about the problems facing the company for more than a year. They also claimed the steps taken by the company to comply

*See **WARN Act** on page 3*

Recent Wage Payment Decision Clarifies Treatment of Bonuses

by Heather L. Wilson



The Indiana Supreme Court has decided that a bonus calculated on the basis of both the employee's production and the expenses of the business overall is not a "wage" under the Indiana Wage Payment Statute. In *Highhouse v. Midwest Orthopedic Institute, P.C.*, 807 N.E.2d 737 (Ind. 2004), Dr. Highhouse was paid an annual salary of $250,000, plus an annual bonus payable on February 28th of the following year. In practice, the bonus was paid at the end of each calendar quarter, based on Midwest's collections for services rendered by Highhouse, less an allocation of expenses of Midwest's overall operations.

In March of 1999, Dr. Highhouse resigned effective June 30, 1999. After his departure, Midwest continued to receive collections for Dr. Highhouse's services rendered before that date, but failed to pay him. Dr. Highhouse claimed he was entitled to bonus payments based on post June 30 receipts, and that the bonus payments constituted "wages" entitling him to twice the amount due, plus attorneys' fees.

The Court determined that Dr. Highhouse's bonus, which depended partially upon results of Midwest's operations, was not a wage. Historically, bonuses have been treated as wages if they were compensation for time worked or individual production, and not linked to the financial success of the company. The Court explained that for practical reasons, a bonus tied to the results of the employer's overall operations is not consistent with the time constraints imposed by the Wage Payment Statute.

Specifically, the statute imposes a penalty on employers when wages are not paid within ten (10) days of the date they are "earned." Here, Dr. Highhouse's bonus was based on collections for services, not billings, which were collected substantially more than ten days after the services were performed. Even assuming the bonus was not "earned" until the patient's bill was paid, the court noted that the allocation for the overall operational expenses could not be calculated within ten days of that time.

When paying bonuses, employers should take the following steps to prevent liability under the Indiana Wage Statute:

- ❖ Provide a written bonus policy setting out how and when the bonus is earned, whether it is discretionary, when the bonus is paid, and what occurs if an employee resigns or is terminated;
- ❖ Include in your policy that bonuses are based on a number of factors, such as the financial success of the business, and not solely on the employee's hours of work or individual production;
- ❖ Obtain written verification that the employee has received a copy of your bonus policy; and
- ❖ Follow your policy. ♦

***WARN Act** continued from page 2*

with the USDA were insufficient and the president knew it. American maintained that the USDA's actions in November were sudden and not reasonably foreseeable. The district court agreed with American and granted summary judgment.

On appeal, the Seventh Circuit disagreed, stating that whether the USDA's actions were reasonably foreseeable depended on how a similarly-situated manager of a meat packing facility would have reacted to these events. The court presumed a manager would know of the conditions of the facility, the extent of the company's attempts to repair the facility, and how the USDA generally operated with regard to noncompliance issues.

As the Court explained, even though American had not previously experienced a plant shut down as a result of its compliance problems, a reasonable, similarly-situated employer might have foreseen that the new USDA rules would result in such an action--especially since American had been unable to provide effective remedies to many of the sanitation problems.

Thus, an employer's subjective view of a situation may not govern whether business circumstances will be seen as foreseeable. Instead, courts will consider whether the employer exercised "commercially reasonable business judgment" compared with similar employers facing similar facts.

These cases remind employers to carefully consider the variety of business and regulatory circumstances that might cause plant closings or mass layoffs. Whenever a shutdown or mass layoff appears imminent, employers covered by the WARN Act should seek legal counsel and proceed with caution, making sure to allow time to give the requisite 60 day notice to affected employees. ♦

Reminder: Over the Counter Medicine Tax Break Now Available

by Michael T. Bindner

The cost of over the counter ("OTC") medicine (that is, medicine purchased without a doctor's prescription) is not tax-deductible as an itemized medical expense on an individual's federal income tax return. The Internal Revenue Code provides that only prescribed drugs and insulin are eligible for this tax deduction.

In the past, the IRS took the position that the cost of OTC medicine could not be reimbursed tax-free (with pre-tax dollars). Such reimbursement occurs when an employee participates in a cafeteria plan that has a healthcare flexible spending account ("FSA") typically funded by the employee, or an employer's health reimbursement arrangement ("HRA") typically funded by the employer.

Last year, the IRS changed its position in a published ruling. Even though a person still cannot deduct OTC medicine costs on a tax return, it is now possible to obtain reimbursement of the cost of OTC medicine from a FSA or HRA with tax-free dollars, as long as the cost is not otherwise reimbursed by insurance or some other source.

This favorable shift of position by the IRS is even more important as we see a trend (perhaps encouraged by the insurance companies) for certain medicines to no longer require a prescription (e.g., Claritan, Prilosec), making them ineligible for insurance reimbursement or co-payment. In some cases, employees are paying more for the OTC medicine than they did when it was only available by prescription.

"Flexible Spending Accounts are an important tool in helping people meet their health care costs," Treasury Secretary John Snow said in an IRS news release that accompanied the ruling. "Since many prescription drugs have moved to the over-the-counter market, this action today makes paying for them a little bit easier to swallow."

The favorable IRS ruling applies to items necessary for treating or alleviating personal injuries or sickness (e.g., antacid, allergy medicine, pain reliever, cold medicine), but not to those which merely maintain general health (e.g., vitamins and dietary supplements). The ruling does not allow reimbursement for the purchase of toiletries (e.g., toothpaste), cosmetics (e.g., face creams), and "sundry items" (the IRS does not state what is included in this category). Apparently, these items are not considered expenditures for medical care but are merely for one's general health.

To take advantage of this ruling, an existing FSA or HRA likely will need to be amended to provide that the cost of OTC medicine qualifies for reimbursement. Both the plan document and the Summary Plan Description should require employees to provide written proof that the expense was incurred, and a statement that it was for medical care of the employee or the employee's spouse or dependents and is not otherwise reimbursable by other coverage.

If an employer decides to amend its plan to allow reimbursement of the cost of OTC medicine, the employer is well-advised to structure it carefully to avoid any reimbursement for expenses incurred before the amendment is executed. ♦

2004 Retirement Plan Limits Adjusted by IRS

The IRS has announced revised limits that apply to employer retirement plans for 2004:

1. The maximum annual contribution to a 401(k) or similar plan is increased from $12,000 to $13,000 for individuals less than 50 years old. The limit will be increased from $14,000 to $16,000 for individuals 50 years and older (the additional $3,000 contribution is sometimes referred to as a catch-up contribution).
2. The maximum annual contribution to a defined contribution plan (both employer and employee) is increased from $40,000 to $41,000. The catch-up contribution is not considered in determining whether this limit is exceeded.
3. The maximum amount of compensation an employer can consider in computing an employee's annual contribution is increased from $200,000 to $205,000.
4. A person is considered "highly compensated" for certain discrimination testing purposes if his or her annual compensation is $90,000 or more.

These changes will be automatically effective for most employer retirement plans, as long as the plan documents incorporate a reference to annual increases in contribution limits. ♦

News from Washington, D.C.

by James D. Masur, II

The nation's capital has generated interest among employers with the following:

1. DOL's FairPay Overtime Initiative Final Rule Issued

The Department of Labor has now issued its Final Rule recasting the "white collar" exemptions to the Fair Labor Standards Act. The Final Rule makes a number of substantive amendments to the "white collar" executive, administrative, professional, and other exemptions to the federal overtime wage statute. Assuming no Congressional intervention, the Final Rule will take effect August 23, 2004. For a copy of the FairPay Initiative, or for more information on the Final Rule, please visit *www.dol.gov* or contact Locke Reynolds.

2. Recordkeeping Implications of New Definition of "Job Applicant"

On March 4, 2004, representatives from the EEOC, the Departments of Labor and Justice, and the Office of Personnel Management (the "Commission") published a proposed guideline ("Interagency Guidance") on the definition of "job applicants" in the context of the Internet and related technologies. Existing recordkeeping guidelines regarding race, gender, and ethnicity set forth in 1978's Uniform Guidelines on Employee Selection Procedures ("UGESP") did not adequately address the phenomenon of electronic recruitment.

Under the UGESP, an employer is required to "maintain and have available for inspection records or other information which will disclose the impact that its tests and other selection procedures have upon employment opportunities of persons by identifiable race, sex, or ethnic group." 29 C.F.R. 1607.4A. Each covered employer is required to maintain and have this information available with respect to applicants.

Traditionally, "applicant" was defined as: "a person who has indicated an interest in being considered for hiring, promotion, or other employment opportunities. This interest might be expressed by completing an application form, or might be expressed orally, depending on the employer's practice."

Under the Commission's proposed definition, an individual will be considered an electronic applicant only if: (1) the employer has acted to fill a particular position; (2) the individual has followed the employer's standard procedures for submitting applications; and (3) the individual has indicated an interest in the particular position.

This definition will apply to those applications submitted via e-mail, third-party job websites, resume banks, employment web pages, electronic scanning technology, applicant tracking systems, and internal databases of job seekers. An example in the Interagency Guidance shows how an ounce of sophistication on the employer's part can be worth a mountain of paperwork.

In the example, individuals register online for customer service representative positions with an internet and cable television service provider. They complete online personal profiles for the employer's resume database. When the company needs to fill two vacancies at its greater New York service center, it identifies 200 recruits from the database who indicated proximity to the New York area. One hundred of these recruits respond affirmatively to the employer's inquiry about current interest in the particular New York vacancies. Even if the employer only interviews twenty-five people for the position, all 100 are considered "applicants."

For employers who use both traditional and electronic methods of recruitment, a separate definition of applicant will apply to each method. Positions being filled only through traditional methods will use the original definition of applicant. When electronic applications will be accepted, the new definition will apply.

The Commission did not intend to eliminate or change the existing definition of applicant. It only intended to clarify those individuals who qualify as "applicants" under the UGESP in the context of the internet and related electronic technologies.

The lesson for employers is to establish well-defined criteria for determining when applications for a position will be considered, and the standard procedures to be followed in order to submit an application. Otherwise, employers may face more extensive recordkeeping (and greater scrutiny) than in the past.

3. Beck Rights Notifications

On April 19, 2004, the Supreme Court refused to hear the UAW's appeal from the District of Columbia Circuit's decision upholding President Bush's Executive Order 13201. This Order requires all government contracts involving more than $100,000 to include a provision requiring all contractors to post notices at all their facilities informing employees of their "General Motors" and "Beck" rights.

These are the rights that protect employees from being forced to join a union or pay mandatory dues for costs unrelated to representational activities. The notice also must tell employees how they may contact the National Labor Relations Board for additional information.

See ***D.C. News*** *on page 6*

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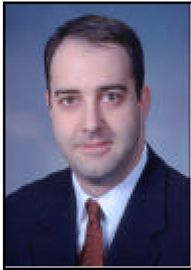
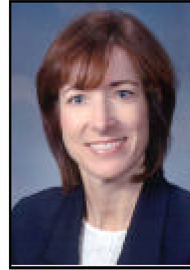


Labor & Employment Group Expands



Locke Reynolds welcomes back Thomas E. Deer and Julia F. Crowe to its Labor and Employment Group. Mr. Deer, who was with Locke Reynolds from 1994 - 1999, had been practicing in Chicago for the past five years. He will lead the Labor and Employment Practice. Ms. Crowe, a former partner at Locke Reynolds, has returned to the firm after a sabbatical from practice. She has extensive experience in employment litigation, including employment discrimination cases and disputes over non-competition agreements. ♦

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In its appeal, the UAW had argued that the order was preempted by the National Labor Relations Act.

The Beck language to be included in a contract can be found at *http://www.dol.gov/esa/regs/compliance/olms/BeckInfo.htm*. The employee notice clause need not be quoted verbatim in a subcontract or purchase order. Instead, the clause may be made part of such agreements by referring to 29 C.F.R. Part 470.

4. Older Workers Not Entitled to Preferences in Retirement Programs

The EEOC has declared that the usual employer practice of factoring in Medicare to retiree packages is not discriminatory. On April 22, 2004, EEOC Chair Cari M. Dominguez said, "This rule is intended to ensure that the ADEA does not have the unintended consequence of discouraging employers from providing valuable health benefits to retirees." She emphasized that the General Accounting Office estimates that 10 million retired individuals aged 55 and over count on employer-sponsored health plans as either their primary source of health coverage or as a supplement to Medicare. "Such benefits are provided on a voluntary basis at the discretion of each employer," Ms. Dominguez said, "and the Commission is acting to preserve these valuable benefits for retirees."

The approved proposal now will be submitted, under Executive Order 12067, to federal agencies for additional review. A final rule will be published in the Federal Register after all of the reviews and approvals are complete. ♦

Employment Law Update does not attempt to offer solutions to individual problems, but rather to provide information about current developments in state and federal labor and employment law. Questions about individual problems should be addressed to the labor and employment attorney of your choice.