VOLUME 74 ◆ NUMBER 3

Employee Benefit Plan Review

DOL and IRS Expand Access to Multiple Employer Plans and Propose to Eliminate the "One Bad Apple" Rule

JOSHUA N. LERNER AND MAUREEN O'BRIEN

The U.S. Department of Labor ("DOL") has published final rules clarifying the circumstances under which "bona fide" groups or associations of employers and professional employer organizations ("PEOs") may be permitted to sponsor single defined contribution multiple employer plans ("MEPs"). Concurrently, the Internal Revenue Service ("IRS") published proposed rules detailing an exception to the "one bad apple" rule for defined contribution MEPs, which rule provides that the failure of one employer to meet established qualification requirements results in the disqualification of the MEP for all participating employers.

The DOL and IRS would facilitate the use of MEPs for employers that might otherwise be concerned that they lacked a nexus of interest to be in a single plan or that a single employer's lack of compliance with applicable law could result in the entire MEP being disqualified.

DOL Final Rule Regarding Sponsoring a MEP

Previous DOL guidance generally limited MEP participation to employers who share a common nexus unrelated to the provision of employee benefits. This is because under the Employee Retirement Income Security Act of 1974, as amended ("ERISA") a defined contribution plan must be established and maintained by an "employer." ERISA defines "employer" as "any person acting directly as an employer, or indirectly in the interest of an employer, in relation to an employee benefit plan; and includes a group or association of employers acting for an employer in such capacity." ERISA does not explain what it means to act "directly as an employer" or "indirectly in the interest of an employer, in relation to an employee benefit plan," nor does it explain what is meant by "group or association of employers." Therefore, there has been general uncertainty regarding the circumstances under which employers can participate in a MEP, even given previous DOL guidance.

In July 2019, the DOL published a final rule making it possible for certain groups of unrelated employers not subject to a collective bargaining agreement to be treated as a single employer for purposes of sponsoring a MEP. The final rule provides that those employers that meet the final rule's test for either being (1) a bona fide group or association of employers, or (2) a bona fide PEO, can act as a single employer for purposes of sponsoring a MEP. The final rule became effective September 30, 2019.

Bona Fide Group or Association of Employers

The DOL clarified the requirements for different employers to be a bona fide group or association. Under the final rules,[1] employers sponsoring a MEP must:

- Have a formal organizational structure with a governing body and bylaws or other similar indications of formality;
- Be controlled, in form and substance, by its employer members, who also must control the MEP;
- Have at least one substantial business purpose unrelated to offering and providing employee benefits to its employer members, though the primary purpose of the association or group may be to offer and provide MEP coverage;
- Limit plan participation to employees and former employees of employer members and their beneficiaries;
- Have members with a commonality of interests, meaning the employers must be either (i) in the same trade industry, line of business or profession, or (ii) have a principal place of business within a region that does not exceed the boundaries of the same state or same metropolitan area (even if the metropolitan area includes more than one state); and
- Ensure that each employer member acts directly as an employer for at least one employee participating in the MEP (even if that employee is a sole proprietor or self-employed person).

These rules are similar to the Association Health Plan rules.[2] Employers and practitioners should monitor any association health plan litigation for potential issues in forming a bona fide group or association of employers.

Bona Fide PEO

DOL also provided guidance on the circumstances under which PEOs can sponsor a MEP for its customers. In order to be a bona fide PEO, the following requirements must be met:

- Perform "substantial employment functions" on behalf of client employers;
- Have substantial control over functions and activities of MEP, as plan sponsor, plan administrator, and a named fiduciary;
- Ensure that each client employer participating in the MEP has at least one employee who is a participant covered under the MEP; and
- Ensure that participation in the MEP is limited to current and former employees of the PEO and of client employers, as well as their beneficiaries.

Existing PEOs largely will meet these requirements. However, all PEOs should examine their plan documents, governance and fiduciary processes to comply with the final rule.

IRS "One Bad Apple" Guidance

Existing IRS regulations provide that the qualification of a MEP is determined with respect to all employers maintaining the MEP and, accordingly, the failure of one employer maintaining the MEP to satisfy qualification requirements results in the disqualification of the MEP for all employers maintaining the plan.[3] This rule is often referred to as the "one bad apple" rule, because the actions of a single employer can disqualify a MEP for all participating employers.

In July 2019, the IRS published a proposed rule[4] that would provide an exception to the "one bad apple" rule for certain qualification failures due to the action or inaction of one participating MEP employer. In general, the employer responsible for the failure (the "Offending Employer") must be either (1) unable or unwilling to make the necessary correction, or (2) unwilling to comply with the MEP administrators' request for information about a failure that the administrator reasonable believes might exist. The following conditions must be met for a MEP to take advantage of the proposed exception.

The MEP Must Satisfy Eligibility Requirements

For the MEP to utilize the exception, the MEP administrator must have established practices and procedures (formal or informal) reasonably designed to promote and facilitate overall compliance with Code requirements. In addition, the MEP plan document must include language describing the procedures that would be followed to address participating employer failures, including the procedures that the administrator would follow if, after receiving notice from the administrator, an Offending Employer fails to take appropriate action.

Even if a MEP meets the eligibility requirements above, it will not be eligible for the exception to the "one bad apple" rule if it is under examination by the IRS (either an employee plan examination or a criminal investigation) at the time a notice is first provided to an Offending Employer.

The MEP Plan Administrator Must Provide Notice and an Opportunity for an Offending Employer to Take Remedial Action

The proposed regulations would require the MEP administrator to provide three notices to an Offending Employer regarding a failure, as follows:

- The first notice must describe (1) the failure (or failures), (2) the remedial actions the Offending Employer would need to take to remedy the failure, (3) the employer's option to initiate a spinoff (discussed further below), and (4) the consequences if the

Offending Employer neither takes appropriate remedial action nor initiates a spinoff, which consequences include the possibility that a spinoff of the plan assets and account balances attributable to the employees of that employer into a separate single-employer plan would occur, followed by a termination of that plan.

- If the Offending Employer does not take appropriate action within 90 days following the first notice, then the MEP administrator must provide a second notice within the next 30 days. The second notice must include all the same information as the first notice, and must also inform the employer that if it fails to take appropriate action within 90 days after the second notice, then a notice describing the failure and the consequences of not correcting that failure will be sent to its employee participants and to the DOL.
- If, by the end of the 90-day period following the second notice, the Offending Employer still does not take appropriate action, then no later than 30 days after the expiration of that 90-day period, the MEP administrator must provide a third notice to the employer, to its employee participants and to the DOL. The third notice must contain the same information as the first notice, but also include the deadline for employer action and an explanation of adverse consequences to participants in the event that a spinoff termination occurs.

The proposed regulations provide that after the Offending Employer has received notice of the failure, the employer has the opportunity to either take appropriate remedial action or initiate a spinoff. The final deadline for an unresponsive participating employer to take one of these actions is 90 days after the third notice is provided.

The Offending Employer Must Fail to Take Appropriate Action

A qualification failure can be either a "potential" qualification failure (*i.e.*, a failure the MEP administrator reasonably believes may exist) or a "known" qualification failure, with each failure requiring the Offending Employer to take action.

If an Offending Employer receives notice of a "potential" qualification failure, the appropriate remedial action for them to take is to provide data, documents or other information necessary for the MEP administrator to determine whether a qualification failure actually exists.

If the information is provided and the MEP administrator determines that a qualification failure does in fact exist (and is solely attributable to that one employer), and the Offending Employer fails to comply with reasonable and timely requests from the MEP administrator to take corrective actions, then the failure becomes a "known" qualification failure.

Once a "known" qualification failure is identified, the MEP would be eligible for the exception to the "one bad apple" rule with respect to that "known" qualification failure by satisfying the proposed rule's requirements, including by providing the three notices to the Offending Employer described above. Notices provided in connection with a "potential" qualification failure would not satisfy the notice requirements for a related "known" qualification failure.

As an alternative to taking appropriate remedial action with respect to either a "potential" or a "known" qualification failure, an Offending Employer may initiate a spinoff by directing the MEP administrator to spin off plan assets and account balances held on behalf of its employees to a separate single-employer plan established and maintained by that employer. In that case, the MEP plan administrator must implement and complete that spinoff within 180 days.

Spinoff Termination

If an Offending Employer fails to take remediation action or initiate its own spinoff during the time period permitted (that is, within 90 days after the third notice), then, for the exception to the "one bad apple" rule to apply, there must be a spinoff of the plan assets and account balances held for the employees of the Offending Employer to a separate plan, followed by a termination of that plan.

The MEP will satisfy this condition, if, as soon as reasonable after the deadline for action by the Offending Employer, the MEP administrator:

1. Provides notice of the spinoff and then-termination to participating employees of the Offending Employer;
2. Stops accepting contributions from the Offending Employer;
3. Implements a spinoff of the plan assets and account balances held for employees of the Offending Employer to a separate single-employer plan and trust that has the same plan administrator, trustee, and substantive plan terms as the MEP; and
4. Terminates the spun-off plan and distributes assets of the spun-off plan to plan participants (and beneficiaries).

Plan termination requirements will apply.

Notice of the spinoff and termination to participating employees must also:

1. Identify the MEP and contact information for the administrator;

2. State the effective date of the spinoff and termination;
3. Include a statement that no more contributions will be made to the MEP;
4. Include a statement that participants and beneficiaries will receive a distribution from the plan; and
5. Include a statement that before the distribution occurs, participants and beneficiaries will receive additional information about their options with respect to that distribution.

The MEP administrator must also report the spinoff and termination to the IRS.

Conclusion

Any employers currently participating in a MEP, either as part of a bona fide group or association of employers or a bona fide PEO, should review the terms of the defined contribution plan to determine whether the recent DOL guidance has been implemented and determine whether any changes are necessary to the plan documents to satisfy either DOL or IRS guidance.

Any employers considering contracting with a PEO or joining a MEP with similar employer-sponsors should review the DOL and IRS guidance with counsel to ensure compliance.

Notes

1. *https://www.govinfo.gov/content/pkg/FR-2019-07-31/pdf/2019-16074.pdf.*
2. *https://www.federalregister.gov/documents/2018/06/21/2018-12992/definition-of-employer-under-section-35-of-erisa-association-health-plans.*
3. *See* 26 CFR 1.413-2(a)(3)(iv).
4. *https://www.govinfo.gov/content/pkg/FR-2019-07-03/pdf/2019-14123.pdf.*

Joshua N. Lerner, a partner in the New York office of McDermott Will & Emery, focuses his practice on a variety of executive compensation, employee benefits, corporate governance, and securities matters. Maureen O'Brien, a partner in the firm's Chicago office, focuses her practice on assisting clients with issues affecting executive compensation and employee benefit plans. The authors may be contacted at jlerner@mwe.com and mobrien@mwe.com, respectively.