# Compensation, Benefits and Employment Law Focus

May 2005

WHITE & CASE

### In This Issue



# IRS Issues Proposed Regulations on Roth 401(k) Plan Contributions

In 2001, as part of the Economic Growth and Tax Relief Reconciliation Act of 2001, Congress added new section 402A to the Internal Revenue Code of 1986, as amended ("Code"), which revised certain rules governing qualified cash or deferred arrangements (*e.g.*, 401(k) plans) and tax-sheltered annuities (*e.g.*, 403(b) plans). Beginning in 2006, 401(k) plans and 403(b) plans may, but are not required to, allow participants to elect to make after-tax Roth IRA-like contributions to a 401(k) plan or a 403(b) plan. On March 2, 2005, the Internal Revenue Service ("IRS") issued proposed regulations regarding certain requirements for Roth 401(k) plan contributions. Although Code Section 402A provides that Roth designated contributions may also be made to a 403(b) plan, the proposed regulations do not address such Roth 403(b) contributions.

## Background

Traditionally, participants in a 401(k) plan elect to have their employer make contributions to the 401(k) plan in lieu of receiving those amounts in cash. These contributions are treated as elective deferrals and such amounts, including earnings, are not includible in the participant's gross income until they are ultimately distributed from the 401(k) plan. However, Code Section 402A provides that if a 401(k) plan includes a "qualified Roth contribution program" a participating employee may opt to make a "designated Roth contribution" to the 401(k) plan in lieu of all or a portion of the participant's elective deferrals under such 401(k) plan. Although designated Roth contributions are generally treated as elective deferrals, the contributions are not excludable from the participating employee's gross income at the time the contribution is made, and, if certain requirements are satisfied, future distributions, including earnings, are not included in the participant's gross income at the time of distribution.

The maximum amount of a participant's designated Roth 401(k) contributions, including any traditional 401(k) pre-tax elective deferral contributions, may not exceed the annual deferral limit for the tax year (*i.e.*, $15,000 for 2006 plus an additional $5,000 for participants eligible to make catch-up contributions). Any excess deferrals attributable to the designated Roth contribution must be distributed no later than April 15 of the year following the year of the designated Roth contribution. In the event that any excess deferrals are not distributed by April 15, the contributions will be subject to double taxation (*i.e.*, the contributions are taxable to the participant when contributed and then again when distributed; however, any earnings attributable to the excess deferrals are taxed only in the year of distribution).

The White & Case LLP COMPENSATION, BENEFITS AND EMPLOYMENT LAW FOCUS is prepared for the general information of our clients and other interested persons. This memorandum is not, and does not attempt to be comprehensive in nature.

COMPENSATION, BENEFITS AND EMPLOYMENT LAW FOCUS authors:

Kenneth A. Raskin, Esq.
New York
kraskin@whitecase.com

Oliver Brettle
London
obrettle@whitecase.com

Ingrid Deuchler
Hamburg
ideuchler@whitecase.com

Stacy L. DeWalt, Esq.
New York
sdewalt@whitecase.com

Nicholas Greenacre
London
ngreenacre@whitecase.com

Dr. Alexander Insam
Frankfurt
ainsam@whitecase.com

Trisha Marlar
New York
tmarlar@whitecase.com


1155 Avenue of the Americas
New York, NY 10036
United States
+1 212 819 8200

## Proposed Regulations

The proposed regulations would apply to plan years beginning on or after January 1, 2006, and would amend the final 401(k) regulations that were issued by the IRS on December 29, 2004. The proposed regulations establish certain special rules applicable to designated Roth contributions and clarify that in general, a designated Roth contribution must satisfy the requirements applicable to elective deferrals under a 401(k) plan including, among other things, nondiscrimination testing, nonforefitability, distribution restrictions, ADP testing and the required minimum distribution ("RMD") rules. Below is a summary of the key provisions of the proposed regulations.

**Designated Contributions**—Under the proposed regulations, a designated Roth contribution must be: (i) designated irrevocably by the employee at the time of election as a Roth contribution, (ii) treated by the employer as includible in income at the time the employee would have received the amount in cash had he not made the Roth contribution election (*e.g.*, by treating the contributions as wages subject to applicable withholding requirements), and (iii) maintained at all times by the plan in a separate account. Because Code Section 402A does not permit employers to make after-tax matching contributions, any employer matching contributions on Roth 401(k) contributions will be treated as pre-tax contributions which should be accounted for separately and will be subject to taxation at distribution.

**Separate Accounting**—Code Section 402A requires that the plan establish separate accounts (*i.e.*, a "designated Roth account") for each participating employee and maintain separate recordkeeping with respect to each such designated Roth account. The proposed regulations clarify that a plan will satisfy the separate accounting requirement if it: (i) maintains a record of contributions and withdrawals of designated Roth contributions, (ii) maintains a record of the employee's investment in the contract (*i.e.*, the designated Roth contributions that have not been distributed), and (iii) separately allocates the gains, losses, and other credits or charges to the Roth contribution account (note, however, that forfeitures may not be allocated to the Roth contribution account).

**ADP Correction**—The proposed regulations provide that Roth contributions are taken into account for purposes of the actual deferral percentage ("ADP") test and the actual contribution percentage ("ACP") test. Under the proposed regulations, if a plan fails the ADP test the plan may allow highly compensated employees ("HCEs") with both pre-tax elective contributions, which are defined by the proposed regulations as elective contributions under a qualified cash or deferred arrangement that are not designated Roth contributions, and designated Roth contributions to elect whether to have the excess contributions attributed to their pre-tax elective contributions or their designated Roth contributions. In the event that an HCE designates the excess contributions as attributable to the designated Roth contributions, the return of such excess contributions will not be included in the HCE's gross income; however, any earnings attributable to the excess contributions will be includable in income. The proposed regulations also provide a similar rule regarding the correction methods a plan may use if it fails to satisfy the ACP test.

**Certain Required Plan Terms**—Although not addressed in the proposed regulations, the preamble to the proposed regulations states that certain aspects of designated Roth contributions must be reflected in the plan's terms and provides the following examples of certain terms which must be set forth in the plan document: (i) if a plan allows an employee to elect whether a distribution will be made from the designated Roth contribution account or another account, the "extent to which a plan so permits must be set forth in the terms of the plan" and (ii) the plan must also provide that, for purposes of Code Section 401(a)(31) regarding eligible rollover distributions, Roth contributions may be rolled over only to another plan maintaining a designated Roth contribution account or to a Roth IRA. Because Roth IRAs are not subject to the RMD rules which generally require participants to begin taking distributions from their retirement plan accounts no later than age 70 ½, it may be possible for employees to avoid such mandatory distributions by rolling over their Roth 401(k) contributions to a Roth IRA.

## Outstanding Issues

**Taxation of Distributions**—While the proposed regulations did not provide guidance with respect to the taxation of the distribution of designated Roth contributions, the preamble specifically requests comments on this issue. Even without additional regulatory guidance, Code Section 402A provides that a "qualified distribution" from a designated Roth account will not be includible in the participant's gross income if two requirements are satisfied. First, the distribution may only be made: (i) on or after age 59 1/2, (ii) to a beneficiary or estate after the death of an individual, or (iii) on account of the individual's disability. Second, the distribution may not be made within the 5-taxable-year period beginning with the earlier of (i) the first taxable year for which the individual made a designated Roth contribution to the plan, or (ii) if a rollover contribution was made to a designated Roth account from a designated Roth account previously established for such individual under another Roth 401(k) plan, the first taxable year for which the individual made a designated Roth contribution to the other Roth 401(k) plan.

## Conclusion

Whether employees will take advantage of the Roth 401(k) option will likely depend on each employee's individual analysis of several factors including: the potential that he will be in a higher or lower tax bracket at the time he begins receiving distributions from his designated Roth account than his current tax bracket, his expectations concerning future interest rates and investment returns, whether he will want access to his Roth 401(k) contributions before age 59 ½, and the potential impact of state taxes. Because much of an employee's analysis of the benefit of a Roth 401(k) will be speculative, due in part to the potential that tax rates may change in the future, plan sponsors who anticipate offering Roth 401(k) accounts in 2006 will need to communicate the availability of the Roth 401(k) contribution option to participants sufficiently in advance of the 401(k) plan's open enrollment period so that participants may analyze the pros and cons of making a Roth 401(k) contribution.

In addition, plan sponsors who intend to offer a Roth 401(k) option will need to:

- Amend their existing 401(k) plans and summary plan descriptions to provide for Roth 401(k) contributions and include provisions detailing the order in which distributions will be made from a participant's traditional, Roth, and/or rollover 401(k) plan accounts.
- Revise their 401(k) recordkeeping procedures in order to satisfy the separate accounting requirement.
- Ensure that their payroll system is equipped to handle after-tax Roth 401(k) contributions.

Finally, both plan sponsors and participants should be aware of the fact that Code Section

402A is scheduled to expire at the end of 2010, although it is possible that Congress will eliminate this sunset provision and make Roth 401(k) contributions permanent.

As always, White & Case LLP would be pleased to assist you in revising your 401(k) plan and participant communication materials to incorporate Roth contributions.

# SEC Adopts New Rule on Mutual Fund Redemption Fees

## Introduction

The Securities and Exchange Commission (SEC) recently released a new rule on short-term trading in mutual funds. Rule 22c-2 allows, but does not require, mutual funds to impose redemption fees. It also requires funds to enter into written agreements with financial intermediaries, which must provide information about shareholder transactions, at the fund's request.

Rule 22c-2 differs from the SEC's initial proposal, which would have required mutual funds to impose a redemption fee of two percent of the amount redeemed on shares held for five business days or less. Under the proposed rule, funds would have also had to require that financial intermediaries provide weekly information about transactions by owners of shares held in intermediary-controlled omnibus accounts.

Rule 22c-2 applies to all funds except money market funds, exchange traded funds, and funds whose purpose is to permit market timing of fund shares. Should those funds opt to impose a redemption fee, they would have to satisfy the rule's requirements.

## Mitigating Short-Term Trading's Effects

Short-term trading and market timing is not illegal, but it can negatively affect long-term investors. Such practices can disturb portfolio management, diminish share value, increase transaction costs, and produce unwanted taxable capital gains. To curb short-term trading, many mutual funds have imposed redemption fees, a small fee imposed if a shareholder redeems shares within a set period after buying them. Enforcement has proved difficult, however, because many individuals invest through financial intermediaries (*e.g.*, broker-dealers, banks, retirement plan recordkeepers). The individuals' shares are held by intermediaries in omnibus accounts, and the individual shareholder is not identified by name.

Under Rule 22c-2, mutual fund directors may impose a redemption fee to reconcile the goals of shareholders using the fund as a short-term investment tool, and long-term investors who would bear the cost of short-term investing. Directors may also use the fee to recoup costs associated with short-term trading and/or discourage market timing and other sorts of short-term trading strategies.

Under the rule, a plan participant shareholder may redeem shares within a minimum holding period—seven calendar days after purchase or longer, at the board's discretion—only if the fund's directors approve a redemption fee or decide that one is unnecessary or inappropriate, enter into a written agreement with the employee benefit plan administrator or recordkeeper, and keep a copy of each agreement for six years.

Before the compliance date, October 16, 2006, each mutual fund's board must consider putting a redemption fee program into place. A fund that already has a redemption fee program in place would meet the rule's requirement, but its board can review its current program to assess whether the fee amount and holding period continue to meet the fund's needs.

## Voluntary Redemption Fee

The rule mandates that the board of directors either impose a fee or decide it is unnecessary or inappropriate.

The rule prescribes that the redemption fee cannot exceed two percent, but the mutual fund's board of directors can impose a lower fee. The redemption fee's proceeds must be paid to the fund itself. The board of directors can use its judgment when setting the fee, which need no longer be based on a strict assessment of administrative and processing costs connected to share redemption.

Variations in redemption fees among mutual funds will probably result in greater complexities and costs for communications with employee benefit plan participants and the operation of investment transactions. As a result, plans may opt to cut the number of investment choices available to participants.

## Agreement with Financial Intermediary

Rule 22c-2 mandates that each mutual fund and financial intermediary enter into a written agreement. The rule defines a financial intermediary as a broker, dealer, bank, insurance company, or, in the case of an employee benefit plan, the plan's administrator or recordkeeper. According to Rule 22c-2, a financial intermediary can be a plan administrator as defined in ERISA Section 3(16)(A) or a plan recordkeeper (*i.e.*, the organization that keeps the plan participants' records). The rule defines a shareholder to include a participant in a participant-directed employee benefit plan.

Under Rule 22c-2, it is the fund's duty to conclude when a financial intermediary's assistance is required to monitor and enforce the fund's market timing policies. Mutual funds can periodically request information from financial intermediaries, or when it appears that an intermediary isn't assessing redemption fees or abusive market timing activity is taking place. A fund does not have to impose a redemption fee to access the information, and it may wish to obtain the information to determine whether a fee should be imposed. In some cases, a financial intermediary may agree to enforce a fund's market timing policies, or establish procedures to prevent violations of the fund's trading policies.

Financial intermediaries must provide the taxpayer identification number of all shareholders who purchased, redeemed, transferred, or exchanged shares held through an account with the financial intermediary. The intermediary must also supply the amount and dates of shareholder purchases, redemptions, transfers, and exchanges.

The intermediary must agree to give effect to mutual fund instructions limiting or prohibiting future purchases or exchanges of funds by a shareholder identified by the fund as having violated its established short-term trading policies.

The fund must also keep a copy of each written agreement for six years.

## Implementation

Rule 22c-2 becomes effective on May 23, 2005, with October 16, 2006 set as the compliance date. When it issued the new rule, the SEC requested additional comments on related issues such as the share accounting method, *de minimis* amounts, waivers covering unanticipated financial emergencies, limiting the redemption fee to investor-initiated transactions, and a uniform standard for any redemption fees charged by a fund.

White & Case LLP will continue to monitor the SEC's efforts to refine Rule 22c-2. In the meantime, we would be pleased to answer any questions you have about the new rule and/or discuss its impact on your benefit plans.

# *European Union Update:* Pensions Act 2004

Many of the provisions of the Pensions Act 2004 that are most likely to create significant liabilities for employers are effective immediately (from 6 April 2005). The remainder of the Act comes into force over the next year.

Various sets of regulations and guidance implementing the detail of the Act have been issued for consultation and further regulations and codes of practice are expected. Set out below are the key changes made by the Act, and the guidance and regulations issued to date.

## The Pensions Regulator and the Pensions Protection Fund

The Pensions Regulator ("TPR") was formally established on 6 April 2005 to replace OPRA, the Occupational Pensions Regulatory Authority.

TPR has wider powers than OPRA, which are intended to allow it to adopt a more proactive and risk-based approach to the protection of the benefits of members of "work-based" pension schemes, meaning both occupational schemes and stakeholder and personal pension schemes to which employees have direct payment arrangements from the employer.

These powers will enable TPR to gather information in order to assess any risk, to take action to reduce or remove the risk by—for example, demanding additional contributions—and to deal with situations in which TPR believes that employers are deliberately avoiding their responsibilities. TPR will also seek to promote good administration of work-based pension schemes.

TPR will concentrate its resources on those schemes where it identifies that the security of members' benefits is at greatest risk. In the highest category of risk are defined benefit (final salary) schemes with greater than 5,000 members and in the lowest are defined contribution (money purchase) schemes with 12 or fewer members.

The Pensions Protection Fund ("PPF") has also become operational from 6 April 2005. The PPF has been established in order to provide compensation to members of occupational defined benefit schemes in the event that their employer becomes insolvent and there are insufficient assets in the scheme to pay the level of benefits to be provided by the PPF. The PPF's assets will be derived from compulsory annual levies on occupational defined benefit schemes together with the assets of schemes it takes over.

## Moral hazard

One of TPR's main objectives is to reduce the risk of financial calls on the PPF and so "moral hazard" provisions have been included in the

Act to deal with situations where TPR believes that an employer is **deliberately** avoiding its pension obligations to leave the PPF to bear the burden of providing members' benefits.

***Since the Pensions Act 1995 came into force, a statutory debt has been imposed on participating employers when an underfunded defined benefit scheme is wound up, or an employer becomes insolvent or otherwise ceases to participate in the scheme (called a "Section 75 Debt").***

The protection this affords to members has been considerably strengthened in recent years by alterations to the basis of valuing the deficit by which the debt is calculated, so that it is now measured by reference to the cost of buying out all benefits due to members with the purchase of annuities. However, until the Act, the Section 75 Debt has only ever affected employers who participate or have participated in the relevant scheme, so that some companies have been able to avoid liability by the use of intra-group transactions and transfers.

The moral hazard provisions in the Act enable TPR to extend the scope of liability from employers to individuals and entities that are "associated" or "connected" with them, including individual directors and other group companies, "group" being defined on a 33% relationship basis.

***These provisions have caused particular concern in the private equity community since private equity houses count as being associated with their investments.***

TPR can act by issuing any of the following:

- **Contribution Notices**—These are notices to pay all or part of a Section 75 Debt and may be issued to employers, associates or connected persons, whether companies or individuals, who have been party to an act or deliberate failure to act, one of the main purposes of which was either (i) to prevent the recovery of all or part of a Section 75 Debt; or (ii) to prevent a Section 75 Debt becoming due, otherwise than in good faith; or (iii) to compromise or otherwise settle or reduce the amount of a Section 75 Debt. The notice must be issued within six years of the relevant act or failure to act and the act or failure to act must have occurred on or after 27 April 2004.

  TPR will also be obliged to apply a reasonableness test, considering factors such as the degree of involvement in the relevant act by the recipient of the notice and its financial circumstances and degree of connection with the employer and the scheme.

- **Financial Support Directions**—TPR may direct the employer or companies which are associated or connected with the employer to put in place financial support for a scheme for a specified period. Such directions can be issued where the employer is a service company or is "insufficiently resourced" (*i.e.*, it is unable to meet at least 50% of the estimated Section 75 Debt), and TPR considers that it is reasonable to do so, on the basis of factors such as the degree of connection between the recipient of the direction and the scheme and the ability of the recipient to pay.

- **Restoration Orders**—TPR can issue restoration orders where there has been a transaction at an undervalue involving the assets of a defined benefit scheme.

  The orders are designed to restore the position to what it would have been had the transaction at an undervalue not been entered into but cannot prejudice any interest in property acquired for value in good faith. Where a recipient fails to comply with a restoration order, TPR may issue a contribution notice.

## Clearance Statements

The Act provides for a procedure under which a person can apply for a clearance statement to ensure that carrying out a particular transaction will not result in TPR fixing that person with liability under the moral hazard provisions. If granted, the statement will be that any proposed action will not result in the applicant being issued with a contribution notice or financial support direction. The statement is binding on TPR unless there has been a material misrepresentation of the facts in the application.

When dealing with applications for clearance, TPR classifies proposed events or transactions as to their potential impact on the relevant scheme by determining whether each event is, is not, or might be "an event affecting an entity which is financially detrimental to the ability of a defined benefit scheme to meet its pension liabilities". For these purposes, TPR proposes to measure the liabilities of a scheme on the basis set out in FRS17 (the relevant accounting standard under UK GAAP) or IAS19 (where it is applicable) unless there is doubt over the business continuing as a going concern. If there is such doubt, the liabilities will be measured on a buy-out basis like the Section 75 Debt.

The proposed use of FRS17 is somewhat controversial, because it sets a higher standard of funding than MFR, the current legal funding obligation which employers owe to defined benefit schemes.

Events such as a return of capital to shareholders in the form of a dividend, the grant of a fixed or floating charge over an employer's assets and a change in control structure are all events which may, in certain circumstances, require notification and for which an application for clearance should be considered. However, such events will not generally require notification if they are transactions carried out on arm's length terms for the purpose of, for example, mergers and acquisitions activity, fund raising or after ordinary commercial activity.

TPR wishes to encourage communication and negotiation between, on the one hand, the directors and other parties connected to the employer and, on the other, the trustees. It intends to act as a referee in this process as opposed to a player. For these purposes, TPR intends to encourage a change in trustees' behaviour so that trustees negotiate with the principal employer in the same way as any key material unsecured creditor would.

***This means that trustees will have to deal properly with conflicts of interest, maintain confidentiality and gain a full understanding of the employer's financial position and, in particular, the potential effect on the employer if the particular event or transaction did not take place.***

## Multi-employer Schemes

Further important regulations are expected to be issued shortly in relation to the calculation of the Section 75 Debt where an employer leaves a multi-employer scheme. These will be designed to deal with situations where the pension liabilities are left in a company which is substantially weaker than the rest of the group and will impose measures such as joint and several liability for all group companies.

## Pension Protection on Transfer of Employment

Regulations came into force on 6 April 2005 which give limited pension protection to employees who are transferring under the Transfer of Undertakings (Protection of pEmployment) Regulations 1981 ("TUPE").

***Subject to certain conditions, the buyer in a business/asset sale must maintain pension provision where the seller offered a pension arrangement to the transferring employees.***

The buyer need not provide the same type of scheme that was provided by the seller but minimum standards apply, whether it chooses to offer a defined benefit scheme or a defined contribution scheme in the form of an occupational scheme or a stakeholder arrangement. It is likely that most buyers will choose offer defined contribution arrangements. Should they do so, they must match employees' contributions to these arrangements of up to 6% of basic pay and these contributions must increase every time there is an increase in pay.

More detail on these new regulations can be found at http://www.whitecase.com/files/tbl_s47Details/FileUpload265/947/The%20shrinking%20pensions%20exemption_0405.pdf.

## Scheme Specific Funding Requirement

The new scheme specific funding requirement will begin to be phased in from September 2005 under the Act and the European Pension Funds Directive. The level of funding required will vary from scheme to scheme by reference to factors like the scheme's investment policy, the age profile of members and likely future staff increases, and the requirement is more onerous overall than the MFR which it replaces.

The requirement applies to the trustees of most occupational defined benefit schemes and puts the onus on them to take the key decisions in relation to scheme funding, regardless of the provisions of the relevant governing documentation. TPR has issued for consultation a code of practice on funding defined benefits that is directed at trustees.

***In summary, the statutory funding objective is that every scheme subject to the new requirement has sufficient and appropriate assets to cover its "technical provisions."***

The technical provisions are an estimate of the assets needed to make provision for the benefits when they fall due. Full actuarial valuations to assess whether or not the statutory funding objective is satisfied must be carried out annually (or at least once every three years if the actuary updates the main valuation on an annual basis).

A statement of funding principles will need to be prepared specifying how the objective will be met, along with a schedule of contributions specifying the rates of contributions to be paid by the employer and active members over a five year period. Where the objective is not met, a recovery plan will need to be agreed between the employer and the trustees and put in place in order to eliminate any shortfall in funding over a fixed period.

TPR will have power to intervene in the absence of agreement between the trustees and employers on funding issues, but again, it is expecting trustees to be more commercial in their behaviour and to deal with the employer (and be treated by the employer) as a material unsecured creditor.

## Amending Schemes

The Act introduces new rules governing the modification of members' pension rights, incorporating additional notification and information requirements that may prove to be a significant administrative burden for schemes. The rules, which will come into effect in April 2006, provide that, where a modification is proposed which might result in a member's subsisting defined benefit rights becoming money purchase benefits or a reduction in the prevailing rate of pensions in payment, the trustees must give the affected member a written explanation of the change and its effect on him. This notice must give him a reasonable opportunity to make representations and the trustees must obtain his written consent to the change.

Where other changes are proposed which might affect a member's subsisting rights, the trustees may either obtain his consent or satisfy requirements to inform the member and ensure that the actuarial value of his benefits is not reduced.

Additional requirements will be imposed on employers to consult with employees or employee representatives, or both, before making major changes to pension schemes. However, until regulations are issued, it is unclear what changes the requirements will apply to and how onerous they will be.

### Trustee Knowledge and Understanding

The Act requires trustees and directors of trustee companies to be familiar with the scheme trust deed and rules, the statement of investment principles, the statement of funding principles and any other documentation setting out administration policy in relation to the scheme. They are also required to have sufficient understanding of the law relating to pensions and trusts and the principles relating to the funding and investment of occupational pension schemes in order for them to be able to exercise properly their functions as trustees.

TPR will publish a code of practice on trustee knowledge and understanding, which will be effective from April 2006 and will provide practical guidance on how to comply with the statutory requirements.

# Draft of a German Anti-Discrimination Act

*"Job Posting: We are looking for a sales manager (male/female), candidate should be between 30 and 40 years old, please send your c.v. to ..."*

Many job postings in Germany are worded in this or a similar way. However, this seemingly innocuous language may have unintended consequences. As a result of a new legislation initiative, such language could in the near future be considered as age discriminating and the company posting the ad might be liable for damages to applicants who do not fulfill these requirements. On December 15, 2004, the Federal Ministry of Justice published a draft bill, titled the German Anti-Discrimination Act, implementing the European anti-discrimination directives prohibiting not only age discrimination, but also other acts of discrimination based on race or ethnic origin, religion or belief, disability, sexual orientation and gender or sex.

By transposing the EU Directives into a national law in Germany, the draft bill aims to improve the rights of employees and individuals seeking employment in the event of discrimination and to facilitate the enforcement of such rights. It is important to note that a violation of the anti-discrimination provisions might not only result in a claim by the employee for compensation of financial losses as currently allowed, but also in a claim for compensation of intangible losses. This duty to compensate for intangible losses would have to be evaluated on a case-by-case basis and is intended to act as "a real deterrent" for employers. It can be expected that the earnings of the company will be central in determining the amount of such damages.

There is no need for employers to act at this point. The bill was read in the Bundestag (German Lower House) on January 21, 2005, and will be discussed again in its various committees. In addition, an initiative taken by the *Bundesrat* (Federal Council) on February 18, 2005, is also of interest in this context, as it provides detailed reasons why the *Bundesrat* will not support an act which goes beyond the standards established by the EU Directives and which contains as many serious flaws as the proposed bill. However, as the proposed bill is not subject to the approval of the *Bundesrat*, the effect of this initiative should not be overestimated. Since Germany is late in implementing the EU Directives and elections for the *Bundestag* will be held next year, we believe that the proposed bill could possibly enter into force within the first six months of 2005.

With this background in mind, we do recommend employers to observe the following guidelines, to avoid possible claims for damages upon approval of the proposed legislation:

## 1. Job Advertisements

Job advertisements should be worded gender-neutral and contain no reference to the applicant's age. Since including a passport photo in the application materials is the usual practice in Germany, employers should also avoid language in advertisements such as "*Please send your job application, together with your application materials and detailed resume, to....*" As the employer could be able to determine race, ethnic origin or religion by the passport photo, such job advertisements would encourage claims.

## 2. Proper Documentation

The draft bill provides for a reversal of the burden of proof and, accordingly, it might become necessary for the employer to present evidence to clear itself from charges of discrimination brought by rejected applicants. Interviews should therefore always be conducted by two individuals on the employer's side to ensure sufficiency of evidence. In addition, after each interview, a summary should be prepared in a timely manner to record the course of the interview and the factual reasons for rejecting the applicant. These factual reasons for rejecting the applicant must not be discriminatory, and in case of doubt, an attorney should be consulted prior to notifying the applicant of the reasons for his rejection. All interview materials should be preserved for a period of at least six months.

For more detailed information, please see our website at http://www.whitecase.de/index.php.

# White & Case LLP

Founded in New York in 1901, White & Case LLP has more than 1,900 lawyers in offices in the United States, Latin America, Europe, the Middle East, Africa and Asia. Our commitment to each region is substantial. We have a critical mass of U.S., English and domestic lawyers throughout the world who are either native to or fully integrated in the regions where they are based.

We represent public and privately held commercial businesses and financial institutions, as well as governments and State-owned entities, involved in sophisticated corporate and financial transactions and complex dispute resolution proceedings.

White & Case is distinguished not only by the depth and scope of its legal advisory services, but also by unmatched experience in the international arena. We are equally adept at assisting clients in the world's major financial centers and in developing or emerging countries. White & Case has the knowledge, infrastructure, technical capability and strategic perspective that are invaluable in helping clients select, implement and coordinate their strategies around the world, and accomplish their objectives at home.

White & Case lawyers throughout our international network function as a united team. Our lawyers are linked by constant interaction and an electronic infrastructure that allows us to bring the firm's experience and all its global resources to bear on clients' most demanding business and legal issues—promptly and cost-effectively without regard to location.

We assist many clients with their most significant and challenging domestic transactions and business ventures. Our clients also are often immersed in cross-border undertakings documented under the governing laws of several countries—and of interest to as many taxing and regulatory authorities; in transactions involving principals and lenders from a dozen nations; or in disputes pertaining to assets in multiple countries. We move quickly, efficiently and with uncommon knowledge of different terrain to complete deals, mitigate problems and evaluate options. ■

ALMATY ANKARA BANGKOK BEIJING BERLIN BRATISLAVA BRUSSELS BUDAPEST DRESDEN DÜSSELDORF FRANKFURT HAMBURG HELSINKI HO CHI MINH CITY HONG KONG ISTANBUL JOHANNESBURG LONDON LOS ANGELES MEXICO CITY MIAMI MILAN MOSCOW MUMBAI NEW YORK PALO ALTO PARIS PRAGUE RIYADH ROME SAN FRANCISCO SÃO PAULO SHANGHAI SINGAPORE STOCKHOLM TOKYO WARSAW WASHINGTON, DC

Please contact Kenneth A. Raskin or any member of White & Case LLP's Executive Compensation, Benefits and Employment Law Practice Group if you have any questions or comments or you would like an additional copy of this or other issues. You may also call upon White & Case LLP's Legislative Services in Washington, DC for information on pending bills, hearing dates, etc. For address changes, or to receive this publication by email, please send your information to white_and_case_ecbel@whitecase.com.

Kenneth A. Raskin, Esq.
New York Office
Telephone: +1 212 819 8508
Facsimile: +1 212 354 8113
kraskin@whitecase.com

Current and back issues of this newsletter are available on our website at www.whitecase.com, along with extensive archives of other newsletters and client memoranda.



00879