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January 9, 2008

Office of Regulations and Interpretations  
Employee Benefits Security Administration  
Attn: 408(b)(2) Amendment  
Room N5655  
United States Department of Labor  
200 Constitution Avenue, NW  
Washington, D.C. 20210

Dear Sir or Madam:

This is in response to the invitation for comment on proposed amendments to 29 CFR § 2550.408b-2(c), published in 72 Fed. Reg. Pages 71004-05 on December 13, 2007.

Our firm represents a number of employee benefit plans subject to ERISA. The referenced regulation relates to the statutory exemption from prohibited transactions which is afforded under §408(b)(2) of ERISA to reasonable contracts or other arrangements between a plan and parties in interest who provide services or lease office space to the plan.

Our comments are directed to the existing provisions of §2550.408b-2(c), reproduced as §2550.408b-2(c)(2) of the proposed amendment, which we believe provide inadequate guidance regarding early termination provisions that are required to make such contracts and arrangements reasonable for purposes of §408(b)(2). It is our experience that the existing language of the regulation is sufficiently vague and ambiguous to allow service providers to assert interpretations that we believe are inconsistent with the protective purpose of the regulation. We have encountered such unreasonable interpretations in particular (though not exclusively) in negotiations with large national firms providing medical network services and pharmacy benefit management services. Such providers typically insist on a stated contract term of three or more years, and resist provisions for earlier termination without cause.

There are two main subjects that are not well defined in the existing regulation and therefore breed controversy. One is the amount of time for which a plan can be bound to a contract that is a "reasonable" contract. This time may be defined either by the notice required for termination without cause, or by the stated term of the contract if it does not contain a provision for earlier termination. The other subject is the amount and type of "loss" for which a service provider may be compensated in event of early termination, without becoming a prohibited "penalty."

In order to provide a framework for our comments, a draft revision of proposed §2550.408b-2(c)(2) is enclosed, with additions printed in bold font and deletions enclosed in brackets. Our specific comments below are keyed to the subparagraphs of the enclosed draft:

**(i) and (ii):** We suggest placing definite bounds on the reasonable duration of a plan's contractual commitment. Though a shorter commitment period may be appropriate in some cases, we believe that the commitment should never exceed one year without opportunity for earlier termination, to protect a plan against disadvantage from changing market conditions or from unsatisfactory services that may not rise to the level of a material breach. One year is the maximum term prescribed in Medicare regulations for a contract for Medicare Part D services provided to a group health plan. In addition to an outside limit, it would be helpful to both parties to have a defined safe harbor that could be relied upon to satisfy the requirement for a "reasonably short notice" of termination in any arrangement. A consensus has developed among many plans and service providers that sixty or ninety days is the shortest notice period that is workable in practice and fair to the parties, and either period would be an appropriate safe harbor.

**(iii):** The existing regulation provides only that leases may have a long stated term, if they also allow early termination without penalty. There is no reason why the same should not be true for service contracts. Repeating the same principle for service contracts would remove any implication that a long stated term is permissible only in leases.

**(iv):** We propose the new first sentence because we believe the regulation is intended to require a contract to permit a plan to terminate early on reasonably short notice without incurring liability for the full damages ordinarily awarded for breach of contract, such as lost profits, and that such damages would therefore be a prohibited "penalty" under the regulation. However, the existing regulation does not say this explicitly, and we have encountered the argument that ordinary contract damages can be a permissible measure of the "loss" for which a service provider may receive compensation in event of a plan's early termination.

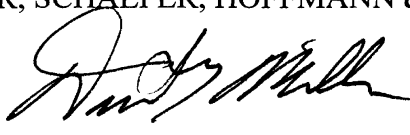
In the third sentence, we believe that it is appropriate to place the burden on the provider or lessor to establish the amount of actual "loss" for which compensation may be paid, because it will be difficult for a plan to obtain this information independently.

In the last sentence, we believe that the only "losses" for which either a service provider or lessor should be permitted to be compensated in event of early termination are the historical, out-of-pocket expense incurred up to the termination notice, which would typically be unrecovered start-up expenses. Prospective expenses after termination are largely controllable as a matter of mitigation, and are difficult to establish with certainty as to amount or causation.

We propose deleting the existing sentence relating to reletting expenses in case of early termination of a lease. Unlike expenses actually incurred prior to termination, future expenses may or may not result from an early termination. A lessor will incur reletting expenses regardless when the plan vacates, and early termination by the plan may only accelerate the time, not the amount, of such expenditure. Permitting recovery of reletting expenses by a lessor opens the door to a claim by a service provider to recover future expense of replacing the plan's business with another customer. The permissible "loss" should be defined by the same principles for service contracts and for leases, and should be limited to retrospective, not prospective, loss resulting from early termination.

Very truly yours,

MILLAR, SCHAEFER, HOFFMANN & ROBERTSON

By 

David G. Millar

Encl.

(2) *Termination of contract or arrangement.* (i) No contract or arrangement is reasonable within the meaning of section 408(b)(2) of the Act and Sec. 2550.408b-2(a)(2) if it does not permit termination by the plan without penalty to the plan on reasonably short notice under the circumstances, **not to exceed one year**, to permit the plan from becoming locked into an arrangement that has become disadvantageous.

(ii) **A contract or arrangement will not fail to satisfy the requirement for reasonably short notice if it permits termination by the plan without penalty on sixty days' notice.**

(iii) A long-term lease which may be terminated prior to its expiration (without penalty to the plan) on reasonably short notice under the circumstances is not generally an unreasonable arrangement merely because of its long term. **Similarly, a service contract which may be terminated (without penalty to the plan) on reasonably short notice under the circumstances is not generally an unreasonable arrangement merely because it contains a stated term longer than the notice required for termination.**

(iv) **A contract or other arrangement that permits recovery of ordinary contract damages, including lost profits, from the plan in event of early termination following reasonable notice imposes a penalty on the plan.** However, a provision in a contract or other arrangement which reasonably compensates the service provider or lessor for **actual** loss upon early termination of the contract, arrangement or lease is not a penalty. For example, a minimal fee in a service contract or lease which is charged to allow recoupment of reasonable start-up costs is not a penalty, **provided that the service provider or lessor substantiates the unrecovered amount of such costs.** [Similarly, a provision in a lease for a termination fee that covers reasonably foreseeable expenses related to the vacancy and reletting of the office space upon early termination of the lease is not a penalty.] Such a provision does not reasonably compensate for loss if it provides for payment in excess of [actual] **reasonable out-of-pocket loss incurred prior to the plan's notice of termination**, or if it fails to require mitigation of damages.