

COURTS MUST SHOW DEFERENCE TO INTERPRETATIONS BY PLAN ADMINISTRATORS (EVEN THE SECOND TIME AROUND)

Insights

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On April 21, 2010 the Supreme Court affirmed that a court must give deference to an ERISA fiduciary's second interpretation of ambiguous plan language, even if the first interpretation made by the fiduciary is struck down by the court as unreasonable. Using a "one strike doesn't mean you're out" analysis, the Court held that where the plan gives the fiduciary the broad authority to interpret the plan, that authority extends to the fiduciary's alternative interpretation if the first was a mistake. The so-called *Firestone* standard of judicial review which requires a court to give deference to a plan administrator's interpretation of a plan provision was upheld as a principle not susceptible to special exceptions. A court's duty is to be sure the fiduciary does not abuse its discretion, not to substitute its judgment if the fiduciary gets it wrong the first time because of an "honest mistake." *Conkright v. Frommert*

The Facts

This case involves a dispute over how a pension plan should account for prior lump sum distributions paid to a group of participants when calculating those participants' current benefits. Like many companies, when Xerox experienced an economic downturn, a number of employees retired and took lump sum distributions from the Xerox pension plan. When business rebounded many of these same individuals were rehired. The Xerox pension plan calculated such a rehired retiree's benefits based on total service, and to avoid "double dipping," the plan provided that the final retirement benefit would be offset for the previous lump sum distribution. The method for calculating the offset was not set out in the plan, so the administrator was required to interpret the plan and determine an appropriate method. The lawsuit was brought because the employees who had received lump sum distributions thought that the plan administrator's offset method was unreasonable.

Initially, the district court found in favor of the plan and held that the offset formula was appropriate. On appeal, the U.S. Court of Appeals for the 2nd Circuit reversed the lower court's ruling on the grounds that the formula was unreasonable and the employees had not been adequately notified of the method that would be used. The case was sent back to the district court for that court to determine the appropriate method for off-setting benefits.

Next, the district court considered other approaches that could be used to reduce the employees' pensions for the past lump sum distributions. The plan administrator submitted an alternative approach for calculating the off-set, arguing that the district court must apply a deferential standard of review to the plan administrator's second formula. The district court refused to apply that standard and adopted the approach proposed by the employees which was to offset the pension by the lump sum amounts paid years ago with no adjustment for the time value of money.

The 2nd Circuit affirmed the district court's ruling and held that the district court did not have to apply a deferential standard of review (i.e., is the administrator's proposition reasonable and if it is, it prevails) to the plan administrator's second approach. As an aside, to those of you who don't spend time thinking about pension plan calculations, the formula adopted by the district court and affirmed by the 2nd Circuit - that the pension plan should not consider how long ago the plan paid the lump sum distributions and how much money the employees could have earned on those distributions - is absurd and runs counter to actuarial principles.

The Supreme Court's Decision

The Supreme Court reversed the 2nd Circuit, holding that it meant what it said in *Firestone* and again in *Metropolitan Life Ins. Co. v. Glenn* involving a plan administrator with a conflict of interest "if the terms of an ERISA plan give a plan administrator discretionary authority to interpret the plan, a court can disturb the administrator's interpretation only if it finds the interpretation unreasonable. This deference to the plan administrator applies even if the administrator is making a second interpretation of a provision.

What this means to Employers

This decision is an affirmation of a long-upheld standard of review directing courts to judge a plan administrator's interpretation of an ambiguous ERISA plan provision on the basis of reasonableness. If such an interpretation is found unreasonable, the plan administrator essentially gets to try again without losing the deferential standard of judicial review. The Supreme Court characterized the administrator's first judgment as a "single honest mistake." There is no substitute for clearly drafted provisions, but ambiguities in plans are common, so when a plan administrator is faced with interpreting a plan provision, the administrator should consider the provision it is interpreting in the context of the plan, make notes of the basis for the

interpretation and discuss the reasonableness of the interpretation with knowledgeable legal counsel.

This Supreme Court Alert discusses highlights of a specific court decision. It is not intended to be, and should not be construed as, legal advice for any particular fact situation.