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LEGAL ALERT

Supreme Court: Plan Participants Can Recover In ERISA Actions Without Showing Detrimental Reliance

On May 16, 2011, the Supreme Court clarified the showing of harm that a participant must demonstrate in order to recover on a claim involving a Summary Plan Description (SPD) that conflicts with the terms of its underlying plan document. The Supreme Court explained that the requisite level of harm for a particular case will be dependent upon the applicable equitable theory of relief. If a plaintiff can satisfy one of the standards, it may then be rebutted by the defendant – if the defendant can demonstrate that the inconsistency was a harmless error.

Prior to today's decision, the U.S. courts of appeals had been divided on the issue of the applicable standard where an SPD conflicts with the terms of a plan document. While the 1st, 4th, 7th, 8th, 10th, and 11th Circuits all required a plan participant to demonstrate some degree of reliance or prejudice on the conflicting documents in order to recover, the 3rd, 5th, and 6th allowed a plan beneficiary to recover where there was a clear and material conflict between the SPD and the plan, regardless of whether the beneficiary could demonstrate reliance on the SPD or prejudice of the conflict.

Background

A traditional defined benefit plan provides an eligible employee with an annuity (an annual benefit payable for the life of the employee) that is calculated as a percentage of the employee's salary multiplied by the employee's years of service. "Salary" may be defined in a variety of ways including the employee's salary over the last several years of service or an average of an employee's three highest year's salary. By design, participants in a such traditional defined benefit plans typically earn most of their benefits in the last several years of service. Also by design, the employer bears the risk of fluctuations in interest rates or the market over the life of the retired employee.

In contrast to traditional defined benefit plans, defined contribution plans, such as 401(k) plans, do not offer fixed assurances of annual benefit for life upon retirement. Instead, the employer and/or employee contributes a certain amount (for example, 5% of each year's salary) to the plan each year. Each plan participant is entitled (depending upon a plan's vesting schedule) to the money allocated to a separate individual retirement account, plus the upside of favorable investment returns. Under a defined contribution arrangement, the plan participant bears the risk of fluctuations in interest rates or the market once contributions are made to the participant's account.

A cash balance plan is a sort of hybrid of a defined benefit plan and a defined contribution plan – borrowing characteristics from each design. Cash balance plans have individual accounts and allocations (like defined contribution plans) but the employer bears the risk of fluctuations in interest rates and the market (like defined benefit plans). The design of cash balance plans allows employees to earn their retirement benefits more evenly throughout their careers, as opposed to defined benefit plans where benefits accrue primarily at the end of an employee's career.

Despite having some of the characteristics of defined contribution plans, cash balance plans are governed by the same rules that apply to defined benefit plans. Many cash balance plans are the result of conversions from traditional defined benefit plans, and there are a variety of ways in which employers may provide for the conversion and transition to the new plan design.

Both defined benefit plans (including cash balance plans) and defined contribution plans are subject to the Employee Retirement Income Security Act of 1974 (ERISA), which requires the creation of a plan document, an SPD which summarizes the plan document in plain language, and the issuance of Summary of Material Modifications (SMM) which describes in plain language any changes made to the terms of a plan.

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Facts Of This Case

In 1998, CIGNA Corp. amended its pension plan from a traditional defined benefit formula to a cash balance plan. Under the conversion, plan participants were provided with a starting balance in their cash balance accounts, which was calculated based, in part, on their accrued benefit under the plan's original defined benefit formula. This amount was then discounted into a lump-sum amount using prescribed interest rates and mortality assumptions.

In order to accommodate the transition of the plan, in over-simplified terms, plan participants were given the greater of a formula based on their accrued benefits under the original defined benefit formula at the time of the plan's conversion, or the amount of their balance under the cash balance benefit.

But this resulted in a phenomenon referred to as "wear away," where certain employees could continue to receive credits under the cash benefit plan but their benefit under the plan would not increase because their benefit based on the original defined benefit formula remained greater than under the cash balance benefit. Although CIGNA issued an SMM and SPD explaining the conversion to a cash balance plan, neither document addressed or mentioned the "wear away" situation.

In 2001, current and former employees of CIGNA filed a class action, alleging that the SPD issued in connection with the conversion to a cash balance formula mistakenly led participants to believe that they would be able to immediately accrue benefits under the cash balance plan. A federal district court held that the SPD was deficient under ERISA because it failed to disclose the "wear-away" phenomenon to participants. According to the district court, the plaintiffs were entitled to recover because they were "likely harmed" by the deficient SPD; it awarded each participant the benefit that the SPD purported to offer. The district court did not require a participant-by-participant showing of injury because of the deficient SPD. The U.S. Court of Appeals for the 2nd Circuit affirmed the district court's decision.

The Court's Ruling

Much of the Court's opinion centered on a technical analysis of the applicable ERISA cause of action section. While the Court concluded that the lower courts' decisions were incorrect in the section of ERISA that they relied on, the Court ultimately found that such relief was permissible, albeit under a different ERISA provision. The section of the law that the Court relied on is a catch-all provision that authorizes a participant, beneficiary, or fiduciary "to obtain other appropriate equitable relief."

According to the Court, because the law authorizes "appropriate equitable relief" for ERISA violations, the relevant standard of harm is dependent upon the specific equitable theory by which relief is provided (there are many such equitable theories). The Court declined to opine on which equitable theory was applicable under these facts and remanded to the district court to make the determination of whether a remedy was appropriate under cited catch-all ERISA provision.

Although the Court declined to make a ruling under these facts, it stated that the relief awarded by the district court could fall within the gambit of "equitable relief," and the Court provided guidance regarding the required level of harm for equitable theories that could be applicable under these facts:

- if the equitable remedy is reformation, a showing of detrimental reliance need not be established;
- if the equitable remedy is equivalent to estoppel (holding someone to what had been promised), a showing of detrimental reliance must be established; or
- if the remedy is surcharge (applicable in the context of a breach of a fiduciary duty), there must be a showing of actual harm, which may come from detrimental reliance or from the loss of a right protected by ERISA.

What It Means For Employers

The Supreme Court's decision will be hailed as a victory for participants of employee benefit plans. The Court's decision holds that participants could be entitled to equitable relief where there are inconsistencies between an SPD and the underlying plan document, and that detrimental reliance need not always be established. The decision will probably result in an increased amount of litigation. In applying such a standard, plan participants may be entitled to relief even if they never read the SPD nor detrimentally relied on it. In addition, the ruling implicitly allows ERISA class actions because participants will not be required to establish individualized harm for certain equitable relief.

Employers should carefully review existing SPDs to ensure consistency with the terms of the plan document. In many cases, you may likely need to add additional provisions to the SPDs or provide a more detailed summary of plan provisions.

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