PROSKAUER ROSE LLP

The ERISA Litigation Newsletter

A report to clients and friends of the firm

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In this month's issue:

Edited by

Robert Rachal &

Russell L. Hirschhorn

Editor's Overview

Our first two decisions featured this month reaffirm a judicial unwillingness to apply laws retroactively to the detriment of plan sponsors and fiduciaries. In *AT&T Corp v. Hulteen*, the Supreme Court held that AT&T did not violate the Pregnancy Discrimination Act by enforcing a pre-Act accrual rule that treated pregnancy leave less favorably than other forms of disability leave. In *Thornton v. Graphic Comm. Conference of the Int'l Brotherhood of Teamsters Supplemental Ret. & Disability Fund*, the Sixth Circuit held that pension benefit enhancements adopted after the employee retired did not constitute "accrued benefits" and thus could be eliminated without violating ERISA's anti-cutback rules, notwithstanding that a recent Treasury regulation may provide to the contrary. Although the specific holdings of each case may have a limited impact on most plans, plan sponsors and fiduciaries should find comfort in their broader reasoning.

Our final article addresses a stock drop case in which the district court ruled that a seller of employer stock had no standing (i.e., no "injury-in-fact") under Article III of the U.S. Constitution to bring a class action. The putative class action alleged it was a fiduciary breach to offer stock that was "artificially inflated" owing to the failure to disclose various problems with the employer's products. As the court concluded, if the allegations were true, by selling the stock the plaintiff benefited, rather than was harmed, by the breach.

Finally, the "Rulings" section of the Newsletter addresses a potpourri of decisions, including a decision from the First Circuit addressing the impact of the Supreme Court's decision in *Glenn v. MetLife*, state regulation of discretionary clauses in group insurance contracts, fiduciary breach claims and whether the failure of an employer to make required contributions to a multiemployer plan makes the employer a plan fiduciary.

Supreme Court Rejects Retroactive Application of Pregnancy Discrimination Act

By Amanda Haverstick

In a 7-2 decision, the United States Supreme Court held that AT&T did not violate the Pregnancy Discrimination Act ("PDA") when it based its calculation of employees' pensions in part on a pre-PDA accrual rule that treated pregnancy leave less favorably than other forms of disability leave. *AT&T Corp v. Hulteen*, No. 07-543 (May 18, 2009). The Court's decision reversed the Ninth Circuit and confirmed the presumption that discrimination statutes will not be applied retroactively.

Background

Plaintiffs were Noreen Hulteen and three other AT&T employees who had taken pregnancy leave before April 29, 1979, the effective date of the PDA. At the time they took leave, AT&T based employee pension benefits on a seniority system (i.e., a system based on length of service) that provided less service credit for pregnancy leaves than it did for other forms of temporary disability leave. When the PDA took effect, AT&T changed its system and began to provide full service credit for pregnancy leaves. It did not, however, retroactively adjust the accrued service credits of Plaintiffs or any other employees who previously had taken pregnancy leave. Therefore, when those employees retired, they received an overall pension amount that was less than it would have been if AT&T had afforded full service credit to their pre-PDA pregnancy leaves.

Plaintiffs and their union filed suit against AT&T in the Northern District of California alleging discrimination on the basis of sex and pregnancy in violation of Title VII of the Civil Rights Act of 1964, as amended by the PDA. Plaintiffs argued that it was unlawful for AT&T, in the present day, to apply a seniority-based pension system that incorporated antiquated pre-PDA accrual rules that had differentiated on the basis of pregnancy. Doing so, Plaintiffs contended, carried forward the old service credit differential so as to produce a disparate effect in the amount of the pension benefits of employees who had taken pre-PDA pregnancy leave. The district court agreed, holding that AT&T had engaged in unlawful pregnancy discrimination, and the Ninth Circuit, *en banc*, affirmed. Because the Ninth Circuit's decision directly conflicted with rulings from other circuits, the Supreme Court granted certiorari to resolve the circuit split.

The Supreme Court's Decision

The Supreme Court reversed the Ninth Circuit and held that AT&T had *not* violated Title VII. Writing for the Court, Justice Souter (who was joined by six other justices), held that although it would be unlawful today for a company to adopt a service credit system containing rules that differentiated based on pregnancy, such a "system does not necessarily violate [Title VII] when it gives

current effect to such rules that operated before the PDA." The Court reasoned that a service-based pension system like that of AT&T qualifies as a "bona fide seniority system" exempt from liability under Section 703(h) of Title VII, as long as the system is not "the result of an intention to discriminate." The Court explained that before the PDA, there could be no doubt that AT&T's pension accrual rules were lawful, because the Court in *General Elec. Co. v. Gilbert*, 429 U.S. 125 (1976), had specifically held that "an accrual rule limiting the seniority credit for time taken for pregnancy leave did not unlawfully discriminate on the basis of sex." Therefore, the Court reasoned, pregnancy discrimination was not unlawful intentional discrimination during the years that AT&T's pregnancy differential was in place, and such differential therefore did not result from an "intention" to discriminate.

Finally, the Court rejected Plaintiffs' argument as to the relevance of the Lilly Ledbetter Fair Pay Act (which recently amended Title VII to provide, *inter alia*, that unlawful compensation discrimination occurs not only when a discriminatory compensation decision is made, but also when an individual "is affected by" the application of such a decision). The Court reasoned that because AT&T's pre-PDA decision not to afford full service credit for pregnancy leave was not unlawful discrimination, Plaintiffs were not "affected by" application of a discriminatory decision or other practice within the meaning of the statute.

Justice Ginsburg authored a dissent, joined only by Justice Breyer. The dissent criticized the majority for perpetuating the effects of the now-discredited *Gilbert* decision, in which, Justice Ginsburg wrote, the Court had "erred egregiously" when holding that pregnancy discrimination was not gender discrimination. The dissent would have held that "AT&T committed a current violation of Title VII when, post-PDA, it did not totally discontinue reliance upon a pension calculation premised on the notion that pregnancy-based classifications display no gender bias."

What This Decision Means for Employers

ATT v. Hulteen is welcome news for employers. The decision reinforces the presumption that employment discrimination statutes will not be applied retroactively — thereby increasing certainty and predictability for employers in this area. For the relatively small number of employers who maintain benefit plans that incorporate pre-PDA accrual features like those in the AT&T plan, the decision also brings direct relief. Such plans may continue to operate, and the plan sponsors will not be forced to go back and recalculate the service credits of participants like the *Hulteen* plaintiffs.

In practice, however, the decision is unlikely to have any broad, concrete impact. The Court could have gone further, by basing its decision on statute of limitations grounds or otherwise providing more guidance as to how the Court may construe

the Ledbetter Act in the future. Instead, the Court gave Ledbetter very little discussion (interestingly, Justice Ginsburg did not even mention it). The decision appears to have been carefully and narrowly crafted to apply only to the specific type of seniority system before the Court.

Sixth Circuit Concludes Post-Retirement Benefit Enhancements Are Not Accrued Benefits

By Russell L. Hirschhorn

In *Thornton v. Graphic Comm. Conference of the Int'l Brotherhood of Teamsters Supplemental Ret. & Disability Fund*, 2009 WL 132356 (6th Cir. May 14, 2009), the Sixth Circuit concluded that pension benefit enhancements provided to retirees did not constitute "accrued benefits" and thus could be eliminated without violating ERISA's anti-cutback rules.

Plaintiff Charles Thornton was a participant in a multi-employer benefits plan that provided retirement benefits to employees in the graphic communications industry. On February 1, 1995, Thornton retired and began receiving retirement benefits from the plan. Over the next four years, the plan was amended on three occasions to award all participants, including Thorton and all other retirees, an increase in benefits. Subsequently, some of the increases were rescinded for participants, including Thorton, who had retired prior to the benefit enhancements becoming effective. The decision to reduce benefits in this way came on advice from the plan's actuaries, who believed that the plan faced a significant funding shortfall, which, if not remedied, would jeopardize the plan's long term financial viability. Thornton thereafter commenced a class action suit claiming that the plan's decision to eliminate one of his benefit increases violated ERISA's rules prohibiting the reduction of accrued benefits.

The Sixth Circuit affirmed the lower court's dismissal (on summary judgment) of Thorton's claims. In so ruling, the court held that a post-retirement increase in benefits does not create an "accrued benefit" for a participant unless it is a benefit promised by the plan document while the employee is employed the employer. The court reasoned that ERISA's anti-cutback provision protects a participant's expectations with regard to retirement benefits at the time the participant retires — that is, the "touchstone of an accrued benefit [is] reliance." Here, Thornton could not have relied on the benefit enhancements because they came about years after he had retired.

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The Sixth Circuit's decision is in harmony with previous decisions from the Seventh and Fourth Circuits. *See Williams v. Rohm & Haas Pension Plan*, 497 F.3d 710 (7th Cir. 2007); *Nat'l Pension Fund v. Comm'r*, 318 F.3d 599 (4th

Cir.2003). Plan sponsors and fiduciaries should proceed with caution, however, when considering whether to reduce benefits this way because in 2005 the Treasury promulgated 26 C.F.R. § 1.411(d)-3, which suggests ERISA's anti-cutback rule treats post-retirement benefit enhancements as accrued benefits. Because the amendment in *Thorton* preceded the promulgation of this regulation, the Sixth Circuit found it unnecessary to decide the import of the regulation.

District Court Concludes Seller of Stock Has No Constitutional Standing to Assert Fiduciary Breach Claim Regarding Artificially Inflated Stock

By Robert Rachal

In *Brown v. Medtronic,* No. 08-4904 (D. Minn. May 26, 2009), Brown brought a class action claiming that Medtronic's stock was an imprudent plan investment for the 401(k) plan because it was allegedly artificially inflated. Brown alleged the stock was inflated because Medtronic had failed to disclose that: (i) a medical product was being withdrawn from the market; and (ii) Medtronic was allegedly illegally marketing another medical product. Brown, however, sold his Medtronic stock before these issues were disclosed to the market.

The district court dismissed the putative class action because Brown failed to show he had standing under Article III of the U.S. Constitution (absent proof of standing, an individual plaintiff cannot represent a class. The court reasoned that, since Brown sold his shares during the period in which he alleged the stock was artificially inflated, he suffered no requisite "injury-in-fact" from the claimed fiduciary breach. Citing the seminal ERISA damages case *Donovon v. Bierwith*, 754 F.2d 1049 (2d Cir. 1985), the court observed that, when the fiduciary breach claim is that the stock was artificially inflated, damages are measured as the difference between the inflated value versus the true value of the stock. Here, the court noted that in this case Brown actually benefitted from the alleged fiduciary breach because he sold his stock at the inflated price instead of its "true" price, and that the Supreme Court had held that simply buying a stock at an inflated price is not sufficient to show damages. *See Dura Pharmaceutical v. Broudo*, 544 U.S. 336 (2005).

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Medtronic is part of a growing line of cases that have begun to closely scrutinize claims to ensure that the plaintiff was harmed by the conduct he or she is challenging. *Medtronic* also draws attention to that in stock drop cases in which "artificial inflation" is alleged as the ground for fiduciary imprudence, damages should be measured by inflation damages. In most instances this is far less than the damages typically sought by plaintiffs in this type of case, which are typically based on an alternative investment analysis.

Rulings, Filings and Settlements of Interest

- In *Denmark v. Liberty Life Assurance Co. of Boston*, 2009 U.S. App. LEXIS 9825 (1st Cir. May 6, 2009), the First Circuit remanded a participant's claim for disability benefits, concluding that the First Circuit's approach to evaluating a denial of benefits where the decision-maker operates under a conflict of interest "require[d] refinement" in light of the Supreme Court's ruling in *Metro. Life Ins. Co. v. Glenn*, 128 S. Ct. 2343 (2008). Previously, the First Circuit took into account the mitigating effect of "market forces" when evaluating conflicts of interest, reasoning that employers are unlikely to contract with insurers who rarely pay benefits claims because the purpose of a benefit plan is to please employees, not to create animosity between employees and the employer, and therefore, only the baseline abuse of discretion standard with "more bite" was necessary in structural conflict cases. However, the court determined that, after *Glenn*, the market forces rationale can no longer be considered by a reviewing court in disregarding a structural conflict without a more searching analysis. In addition, where a conflict of interest has affected a benefits denial decision, the court stated that "such a circumstance may justify a conclusion that the denial was itself arbitrary and capricious (and, thus, an abuse of discretion)." Finally, on the issue of discovery outside the administrative record, the court's reading of *Glenn* allows some discovery to be permitted into the issue of whether a structural conflict "morphed" into an actual conflict, but such discovery should be "allowed sparingly" and "narrowly tailored so as to leave the substantive record essentially undisturbed." The court warned that, in light of *Glenn*, plan administrators can be expected, as matter of course, to document the procedures used to prevent or limit the effect of structural conflicts.

- The May 2008 and April 2009 editions of the *ERISA Litigation Newsletter* reported on the trend towards state regulation of discretionary clauses in group insurance contracts providing medical, life, disability or other benefits for ERISA plans. Recently, in *McClenahan v. Metropolitan Life Ins. Co.*, No. 08-00254 (D. Colo. May 7, 2009), the District of Colorado joined the growing number of courts sustaining prohibitions on discretionary clauses against claims of ERISA preemption. Like other courts deciding the issue, the *McClenahan* court concluded that the Colorado ban substantially affected the parties' risk-pooling arrangement, and was thus an insurance law spared by ERISA's "savings" provision. The court likewise rejected the argument that such a ban created an impermissible conflict with ERISA, observing that ERISA does not guarantee any particular standard of judicial review for benefits determinations. In an interesting twist, however, the *McClenahan* court declined to apply the Colorado ban to the case before it. In doing so, the court held that application of the 2008 ban to benefits determinations in 2006 would violate Colorado's constitutional prohibition against retroactive

legislation. Thus, the court applied the "arbitrary and capricious" standard dictated by the plan's terms, and held that Met Life's termination of McClenahan's disability benefits were supported by the administrative record and based on a reasonable interpretation of plan terms.

- In *Blankenship v. Chamberlain*, 2009 WL 1421201 (E.D. Mo. May 20, 2009), the district court dismissed breach of fiduciary claims against an ESOP trustee. Plaintiffs alleged that Chamberlain, the trustee as well as the company's CEO, president, and chair of its board of directors, breached his fiduciary duties by, *inter alia*, holding his multiple roles under a conflict of interest, using company resources for personal gain, removing management personnel, and making imprudent business decisions. They also alleged that his plans to dissolve and liquidate the company would render the ESOP valueless and result in a complete loss of retirement benefits. Plaintiffs, however, failed to allege that Chamberlain was acting in a fiduciary capacity when he made the allegedly injurious decisions. Thus, the claims were dismissed without prejudice, and plaintiffs were given leave to amend their complaint. Additionally, the court held that ERISA preempted plaintiffs' Missouri law claims for common law breach of fiduciary duty and removal of the trustee. It also followed other courts in ruling that the ESOP lacked standing to bring a Section 502(a)(2) claim.

- In *Poore v. Simpson Paper Co.*, 2009 WL 1409257 (9th Cir. 2009), plaintiffs-retirees commenced an action against Simpson Paper Co., contending that it violated ERISA and the LMRA when it terminated retiree health benefits without first negotiating with the Union, as they argued was required by the plan documents. The Ninth Circuit held that the governing plan term was ambiguous and thus inappropriate for consideration on summary judgment. With respect to the ERISA claim, the court determined that the early retirees had ERISA standing to bring their claims as plan "participants" and that, under *LaRue v. DeWolff, Boberg & Assocs.*, 128 S.Ct. 1020 (2008), plaintiffs were not required to show that their healthcare benefits had vested in the way that pension benefits are vested. The court reasoned that *LaRue* "loosen[ed] the requirement that the claimed benefits be 'vested,' at least insofar as vested means permanently fixed and unalterable."

- In *In re Halpin*, 2009 U.S. App. LEXIS 10037 (2d Cir. 2009) (unpublished), the Second Circuit ruled that unpaid contributions owed by an employer to a multiemployer plan are not plan assets. In so holding, the court determined that an employer does not automatically become an ERISA fiduciary by virtue of failing to make contractually required contributions to a multi-employer plan. The court's decision is an accord with the position taken by the DOL as well as other circuits (Eighth, Ninth, Tenth, and Eleventh) to have considered the issue.

Employee Benefits Litigation

Proskauer Rose's Employee Benefits Litigation Group is a significant component of the Firm's renowned Labor and Employment Law Department, which has nearly 175 attorneys.

The Employee Benefits Litigation Group is led by Howard Shapiro and Myron Rumeld. The Group defends complex and class action employee benefits litigation.

For more information about this practice area, contact:
Howard Shapiro
504.310.4085 – howshapiro@proskauer.com

Myron D. Rumeld
212.969.3021 – mrumeld@proskauer.com

Robert Rachal
504.310.4081 – rrachal@proskauer.com

Russell L. Hirschhorn
212.969.3286 – rhirschhorn@proskauer.com