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# PENSION & BENEFITS



**DAILY**

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## **Court Review**

In 2006, the federal courts split on a variety of issues, including the controversial question of whether cash balance pension plans discriminate against older workers. The courts also divided on a relatively new issue, that being whether former employees who have received full distributions from their defined contribution pension plans have standing to pursue fiduciary breach claims. Both issues are likely to make their way to the federal appeals courts in 2007.

### **Cash Balance Plans, Former Employee Standing Top ERISA Legal Issues of 2006**

**T**he year 2006 was in many ways like recent years where the primary focus of Employee Retirement Income Security Act litigation has been on cash balance plans and defined contribution pension plans.

Several federal courts addressed in 2006 the issue of whether cash balance pension plans discriminate against older workers in violation of ERISA. By year-end, the courts were divided almost evenly on the issue, and it seems inevitable that the issue will make its way to the federal appeals courts this year.

While there was a slowdown in employer “stock drop” cases, there were several settlements approved in such cases and at least one court, after a full bench trial, ruled in favor of an employer and found no fiduciary breach under ERISA when the employer continued to offer its stock as a retirement plan investment option when the employer was facing financial difficulties.

On a related front to the stock drop cases was the issue, often raised in such cases, of whether former employees who receive full distributions of their plan accounts have standing under ERISA to pursue fiduciary breach claims as plan “participants.” By the end of

2006, at least a dozen federal courts had addressed the issue with the majority of courts finding that former employees who receive full distributions of their benefits are no longer participants and therefore lack standing to sue for fiduciary breach.

In terms of health benefits, the major issue facing the federal courts in 2006 was the issue of retiree benefits. These cases were typically decided on a case-by-case basis that looked primarily at whether employers had intended to “vest” the retirees with health benefits that could not be altered.

### **Cash Balance Plans and Age Discrimination**

As in past years, the controversy over the legitimacy of cash balance pension plans continued in 2006. The Pension Protection Act of 2006, however, could play a role in the future outcome of these cases.

The PPA addresses on a prospective basis several issues raised in cash balance plan litigation, including the issue of whether such plans discriminate against older

workers. In pertinent part, the PPA provides explicitly that cash balance pension plans and other plans that feature hypothetical accounts for individual workers do not violate the Age Discrimination in Employment Act.

In addition, the PPA provides that hybrid plans such as cash balance plans will not be treated on a going-forward basis as violating the ADEA and ERISA's age discrimination rules if a plan participant's "accrued benefit" would be equal to or greater than that of any similarly situated younger employee who is or could be a participant.

Moreover, the PPA provides that in determining whether a plan discriminates on the basis of age, benefits may be calculated in ways other than as an accrued benefit such as by using the balance of a hypothetical account or the current value of the accumulated percentage of the participant's final average compensation.

**The IBM Decision.** Within days of the passage of the PPA, the U.S. Court of Appeals for the Seventh Circuit issued its long-awaited decision in a challenge to a cash balance plan sponsored by IBM Corp. In *Cooper v. IBM Personal Pension Plan*, 457 F.3d 636, 38 EBC 1801 (7th Cir. 2006), a unanimous appellate panel ruled that IBM's cash balance plan did not discriminate against older workers (151 PBD, 8/8/06; 33 BPR 1867, 8/8/06).

The Seventh Circuit, in reversing a lower federal court's decision, found that the terms of IBM's cash balance plan were age-neutral and thus did not violate ERISA's age discrimination prohibition. In so ruling, the appeals court found that ERISA's age discrimination rule for defined benefit plans, such as cash balance plans, should be treated the same as ERISA's similar rule for defined contribution plans. As a policy matter, the Seventh Circuit also reasoned that the IBM employees who brought the lawsuit failed to recognize the "time value of money."

In late November, the plaintiffs in the *Cooper* case filed a petition seeking Supreme Court review. The justices have not yet decided whether they will take up the case.

Many practitioners predicted that the passage of the PPA combined with the *Cooper* decision would make it more difficult for plaintiffs to succeed in age discrimination challenges to cash balance plans (166 PBD, 8/29/06; 33 BPR 2078, 9/5/06). But district courts, primarily those within the jurisdiction of the U.S. Court of Appeals for the Second Circuit, have continued to split on whether cash balance plans discriminate against older workers.

**Courts Finding No Discrimination.** In the following cases, the federal courts dismissed claims that cash balance plans discriminate against older workers:

- Several days before the PPA was passed and the *Cooper* decision was issued, a federal district court in New York found that Equitable Life Assurance Society of America's cash balance pension plan treated all participants equally and thus did not violate ERISA's age discrimination prohibition (*Hirt v. Equitable Retirement Plan for Employees, Managers and Agents*, 441 F. Supp. 2d 516, 38 EBC 2279 (S.D.N.Y. 2006) (140 PBD, 7/24/06; 33 BPR 1749, 7/25/06)). The court found that Equitable's plan did not provide any rights or features to one group of participants that were different from those provided to another group of older, or younger,

participants. According to the district court's docket, a notice of appeal was filed by the plaintiff's attorney.

- Shortly after the passage of PPA and the issuance of the *Cooper* decision, a second judge in the same New York federal court found that PriceWaterhouseCoopers LLP's cash balance plan did not discriminate against older workers (*Laurent v. PriceWaterhouseCoopers LLP*, 39 EBC 1336 (S.D.N.Y. 2006) (173 PBD, 9/8/06; 33 BPR 2176, 9/12/06)). While the judge found that PriceWaterhouseCoopers violated ERISA by defining "normal retirement age" in its cash balance plan as "five years of service," the court found that the plan did not violate ERISA's age discrimination provision. Citing the *Cooper* decision, the court said the effect of a younger employee's pay credits being worth more than those paid to older workers was not caused by discrimination, but by the "time value of money."

- In September, a federal court in Kentucky dismissed claims that World Color Press Inc.'s cash balance plan discriminated against older workers (*Drutis v. Quebecor World (USA) Inc.*, 38 EBC 2761 (E.D. Ky. 2006) (188 PBD, 9/29/06; 33 BPR 2355, 10/3/06)). The court found in that case that the phrase "rate of benefit accrual" in ERISA's age discrimination provision for defined benefit plans should be read the same as the rule for defined contribution plans. The case is currently on appeal to the U.S. Court of Appeals for the Sixth Circuit.

**Cases Finding Age Discrimination.** In the following decisions, federal courts found that ERISA's age discrimination rules were violated by cash balance plans:

- In March, several months before the passage of the PPA and the *Cooper* decision, a federal judge in Connecticut refused to dismiss claims that FleetBoston Financial Corp.'s cash balance plan discriminated against older workers in violation of ERISA (*Richards v. Fleet-Boston Financial Corp.*, 427 F. Supp. 2d 150, 37 EBC 1449 (D. Conn. 2006) (65 PBD, 4/5/06; 33 BPR 939, 4/11/06)). The judge rejected the decisions of other federal courts that had found that ERISA Section 204(b)(1)(H)'s reference to "the rate of an employee's benefit" accrual should be measured in terms of the change in the balance of each participant's hypothetical account. Instead, the court said Section 204(b)(1)(H) required that "the rate of an employee's benefit accrual" be measured solely in terms of an annuity payable at normal retirement age.

- In October, a third judge in the Southern District of New York disagreed with the reasoning of the judges in the *Equitable* and *PriceWaterhouseCoopers* cases and found that J.P. Morgan Chase's cash balance plan discriminated against older workers in violation of ERISA (*In re J.P. Morgan Chase Cash Balance Litigation*, 39 EBC 1325 (S.D.N.Y. 2006) (212 PBD, 11/13/06; 33 BPR 2638, 11/7/06)). The judge said that courts which have found cash balance plans nondiscriminatory have misinterpreted the phrase "rate of benefit accrual" in ERISA. In addition, the judge also raised a new issue not addressed by other courts, that being the fact that employers "must know an individual's age" in converting a participant's account to an age 65 annuity.

- Most recently, a fourth judge in the Southern District of New York ruled that Citigroup Inc.'s cash balance plan discriminated against older workers in violation of ERISA (*In re Citigroup Pension Plan ERISA Litigation*, (S.D.N.Y. 2006) (239 PBD, 12/15/06; 33 BPR

2929, 12/19/06)). According to the district court, ERISA's anti-discrimination provisions governing defined contribution and defined benefit plans are different and to treat cash balance plans as defined contribution plans for the purpose of the anti-discrimination provisions ignores "the plain language of the statute" as well as the critical distinctions between defined contribution and defined benefit plans.

**Attorneys Offer Predictions on Appeal.** Attorney Edgar Pauk of New York predicts that the Second Circuit will not follow the lead of the Seventh Circuit. Pauk is the lead attorney for the plaintiffs in the *Hirt* case and is co-counsel in the *Citigroup* case, both of which were decided by judges in the Southern District of New York. In *Hirt*, the judge found no age discrimination while the judge in *Citigroup* found that the plan discriminated against older workers.

"Based on the Second Circuit's decision in *Esden v. Bank of Boston*, [229 F.3d 154, 24 EBC 2761 (2d Cir. 2000)(180 PBD, 9/15/00; 27 BPR 2270, 9/19/00)] I believe that the Second Circuit will not follow the Seventh, but will hold that, because cash balance plans are defined benefit plans, the test for age discrimination requires projecting interest credits to normal retirement age. In other words, the prohibition against reducing the rate of accrual refers to the rate of accrual of the accrued benefit, i.e., the benefit payable at the normal retirement age," Pauk told BNA Jan. 2.

"While one would be a fool to predict the outcome of litigation with any certainty, I believe that the Second Circuit will pull the plug on many cash balance plans, revealing them to be only the latest gimmick for depriving employees of the benefits they were led to expect. If a cash balance plan calibrates pay credits and interest credits, so that the former increase at the same rate the latter decrease, a cash balance plan would be perfectly lawful," Pauk said.

Pauk also told BNA he believes the PPA will not correct cash balance plans to prevent age discrimination. "With regard to the Pension Protection Act, its name is as deceptive as most cash balance plans, which are touted to help employees, while cheating them. There is no 'Protection' in the Act, but an effort to permit age discrimination by another name," Pauk said.

Attorney Nancy Ross of McDermott Will & Emery, Chicago, told BNA Jan. 8 that she believes there is a "high probability" the Second Circuit will follow the Seventh Circuit. Ross represents the defendants in the *Hirt* case presently on appeal in the Second Circuit.

According to Ross, the Second Circuit will likely follow the Seventh Circuit because "the Seventh Circuit's decision is eminently reasonable given the legislative history and appropriate analysis which shows that the difference in benefits is not due to age, but rather, to the time value of money."

In addition, Ross said the Seventh Circuit "has historically been one of the most respected circuits in the nation and its opinion likely will be given significant consideration by the Second Circuit."

Moreover, Ross said the PPA's "prospective only" language would be given meaningful deference by the Second Circuit. The PPA's language will "likely suggest to the court that Congress does not want to invalidate cash balance plans per se due to strong public policy reasons (the tenuous state of the nation's voluntary pension system) and the court should not judiciously

eliminate what Congress deems appropriate or even necessary," Ross said.

## Former Employee Standing

Another issue that divided the federal courts in 2006, even more so than the cash balance plan issue, was whether former employees who receive full distributions of their defined contribution pension plan accounts have standing as "participants" to pursue fiduciary breach claims.

The issue has been raised in various cases, but most prominently in the employer "stock drop" cases. The argument often raised by defendants in such cases is that former employees who have received a full distribution of benefits no longer have a colorable claim to vested benefits and therefore do not qualify as participants with standing under ERISA.

On the other side of the coin, plaintiffs' attorneys often argue that former employees have standing and should not be prevented from pursuing fiduciary breach claims. One argument offered by plaintiffs' attorneys is that "but for" the fiduciary breach, the former employee would have received more benefits when he or she received his or her distribution.

**Courts Finding No Standing.** The following is a summary of decisions by courts that ruled in 2006 that former employees lacked standing because they did not qualify as plan participants:

- After at least three years of litigation, a federal court in Rhode Island dismissed a lawsuit by former employees of Textron Inc. alleging the company breached its ERISA fiduciary duties by allowing the employees to invest in Textron stock that was artificially inflated. The court reasoned that the employees did not meet the definition of participants under ERISA because they had no reasonable expectation of returning to Textron as employees, nor did they have colorable claims for vested benefits (*Lalonde v. Textron Inc.*, 418 F. Supp. 2d 16, 36 EBC 2826 (D.R.I. 2006)(44 PBD, 3/7/06; 33 BPR 670, 3/14/06)).

- In dismissing a lawsuit by two former employees against Dynegy Inc. and members of Dynegy's retirement plan committee, a federal court in Texas ruled that the employees were no longer "participants" when they filed their lawsuit and thus lacked standing. According to the court, the employees were not seeking vested benefits, but instead were seeking damages for the defendants' alleged fiduciary breaches (*Holtzschler v. Dynegy Inc.*, 38 EBC 1150 (S.D. Tex. 2006)(56 PBD, 3/23/06; 33 BPR 811, 3/28/06)).

- A New York federal court ruled that a former employee of Solutia Inc. lacked standing to sue the company alleging it breached its fiduciary duties by investing 401(k) plan assets in Solutia stock up until two days before the company filed for bankruptcy. The court found that the employee was no longer a "participant" in the plan because he had received a full distribution of his benefits (*Dickerson v. Feldman*, 426 F. Supp. 2d 130, 37 EBC 1503 (S.D.N.Y. 2006)(64 PBD, 4/4/06; 33 BPR 943, 4/11/06)).

- In an unpublished decision, a federal judge in New Jersey ruled that a former employee who received a full distribution of his tax code Section 401(k) plan account lacked standing to sue his employer alleging it breached its fiduciary duties by allowing its stock to be

offered as an investment option. The judge determined that the former employee was no longer a “participant” because he was not pursuing a colorable claim for vested benefits, but instead was seeking damages for alleged fiduciary breaches (*Graden v. Conexant Systems Inc.*, 38 EBC 1444 (D.N.J. 2006)(64 PBD, 4/4/06; 33 BPR 944, 4/11/06)).

■ In July, a federal court in Ohio held that a former American Electric Power Co. employee lacked standing to sue the company alleging it breached its fiduciary duties through its administration of a 401(k) plan. The court found that the employee was no longer a plan “participant” because he had divested himself of his plan holdings several months after he filed the lawsuit. In addition, the court said the employee was not pursuing a colorable claim for “vested benefits” but instead was seeking “speculative” benefits he would have received if AEP had not breached its fiduciary duties (*In re AEP ERISA Litigation*, 437 F. Supp. 2d 750, 38 EBC 1467 (S.D. Ohio 2006)(135 PBD, 7/17/06; 33 BPR 1690, 7/18/06)).

■ A judge in the Northern District of Illinois ruled in August that a former employee of Motorola Inc. lacked standing to sue the company alleging it breached its fiduciary duties by investing 401(k) plan assets in Motorola stock. According to the court, instead of seeking “vested benefits” that would give him standing as a plan participant, the employee sought damages represented the difference between what he was paid when he cashed out his 401(k) plan and what his account would have been had Motorola not breached its fiduciary duties (*Howell v. Motorola Inc.*, 38 EBC 1979 (N.D. Ill. 2006)(158 PBD, 8/17/06; 33 BPR 2007, 8/22/06)).

■ A federal court in Indiana ruled that two former employees of Guidant Corp. lacked standing to sue the company alleging it breached its fiduciary duties by investing retirement plan assets in the company’s stock when it was no longer a prudent investment. In granting Guidant’s motion to dismiss the lawsuit, the court found that the employees had both taken full distributions from the plan and had requested “actual damages” to the plan for amounts by which Guidant was allegedly unjustly enriched by its fiduciary breach (*In re Guidant Corp. ERISA Litigation*, 38 EBC 2554 (S.D. Ind. 2006)(182 PBD, 9/21/06; 33 BPR 2291, 9/26/06)).

■ In October, a federal district court in New York held that a former employee of New York Community Bancorp lacked standing to sue the company alleging it mismanaged a 401(k) plan that offered employees the opportunity to invest in the employer’s stock. Among other things, the court said the employee had no colorable claim for ERISA benefits because she took a full distribution of her 401(k) plan account before she filed the lawsuit (*Caltagirone v. New York Community Bancorp*, 39 EBC 1518 (E.D.N.Y. 2006)(207 PBD, 10/27/06; 33 BPR 2598, 10/31/06)).

■ Most recently, a federal court in Massachusetts ruled that two former employees of W.R. Grace & Co. lacked standing to sue the company’s defined contribution pension plan fiduciaries alleging they breached their duties by heavily investing in W.R. Grace stock when it was an imprudent investment. The court found that the employees did not qualify as “participants” with standing because they sought the “lost return” on the money their plan accounts would have received if the fiduciaries made more prudent and loyal investment

of plan assets (*Evans v. Akers* (D. Mass. 2006)(234 PBD, 12/6/06; 33 BPR 2877, 12/12/06)).

**Courts Finding Standing.** The following is a summary of the decisions by a minority of courts that ruled in 2006 that former employees qualify as “participants” with ERISA standing:

■ In a case by a group of retirees who alleged their employer breached its fiduciary duties by improperly valuing their profit-sharing plan accounts, a federal court in California held that the retirees, who had received lump-sum distributions of their benefits, had standing because they alleged that the fiduciaries profited and that payment of their plan benefits was part of the fiduciaries’ scheme to misuse plan assets (*Ellis v. Hollister Inc.*, 38 EBC 1211 (E.D. Cal. 2006)(80 PBD, 4/26/06; 33 BPR 1117, 5/2/06)).

■ In July, a federal court in Missouri ruled that a former employee of Aquila Inc. had standing to sue the company alleging it breached its fiduciary duties by offering its inflated stock as a retirement plan investment option. The court found the employee had ERISA standing because she alleged that “but for” Aquila’s alleged ERISA violations, her account balance would have been larger at the time she took her distribution (*In re Aquila ERISA Litigation*, 38 EBC 1838 (W.D. Mo. 2006)(139 PBD, 7/21/06; 33 BPR 1751, 7/25/06)).

■ A judge in the Southern District of New York certified as a class action a lawsuit by former employees of Polaroid Corp. alleging the company’s officers and directors breached their fiduciary duties by maintaining retirement plan investments in Polaroid stock despite knowing it was imprudent. In so ruling, the judge rejected Polaroid’s contention that the employees lacked standing because they had received full distributions of their benefits. According to the court, the employees alleged that the distributions they received under the plan were reduced because of the fiduciary breaches and such claims are “within the zone of interests ERISA was intended to protect” (*In re Polaroid ERISA Litigation* (S.D.N.Y. 2006)(190 PBD, 10/3/06; 33 EBC 2413, 10/10/06)).

■ In November, a federal judge in the Northern District of Illinois certified a class action filed by current and former participants in a 401(k) plan sponsored by Aon Corp. who alleged the company breached its fiduciary duties in offering its stock as a plan investment option. The judge rejected Aon’s contention that the case was not appropriate as a class action because many of the potential class representatives and members had received full distributions from the 401(k) accounts and thus lacked standing to pursue fiduciary breach claims (*Smith v. Aon Corp.*, 39 EBC 1715 (N.D. Ill. 2006)(232 PBD, 12/6/06; 33 BPR 2877, 12/12/06)).

**Attorneys Debate Former Employee Standing.** Paul J. Ondrasik Jr. of Steptoe & Johnson, Washington, D.C., told BNA Jan. 5 that the former employee standing issue has become a very interesting issue for ERISA litigators.

Ondrasik, who has represented several employers in the stock drop cases, told BNA there are three reasons why the courts that have found no former employee standing are correct. The first reason is that, from a statutory standpoint, there can only be one definition of “participant,” Ondrasik said. According to Ondrasik, under Department of Labor regulations, for example, only active participants are entitled to plan disclosures.

“If you have a broader definition for standing, then former participants would get disclosure that the DOL doesn’t require,” Ondrasik said.

The second reason is that the plaintiffs’ position that former employees have standing is flawed from the perspective that former employees typically are interested in receiving money as a remedy for a fiduciary breach, while active participants are often interested in having the plan reformed in some manner, Ondrasik said. Former employees are “just not the right representative” and they typically are seeking individual relief rather than relief on behalf of the plan, Ondrasik said.

The “clincher” for why the courts are correct that former employees lack standing as participants is that Congress did amend ERISA to give standing in limited circumstances to former employees. “If Congress wanted to give standing to former employees in the fiduciary breach context, they knew how to do it,” Ondrasik said.

Ondrasik also noted that the overriding issue is that several other people can bring fiduciary breach claims, such as active participants, new plan fiduciaries, and the Secretary of Labor. The issue of former employee standing will not “kill stock drop cases” because if there is a “real gripe,” then there are a lot of other appropriate plan representatives to bring the claim, Ondrasik told BNA.

Edward Ciolko of Schiffrin & Barroway, Radnor, Pa., told BNA Jan. 5 that cases dealing with former employee standing are now on appeal in at least eight federal appeals courts. Ciolko is a plaintiffs’ attorney who represents former employees in a number of the cases decided in 2006.

Ciolko said he feels very confident that, given the recent “momentum” change in district court decisions and the DOL’s “strong stand supportive” of former employees’ standing that plaintiffs will ultimately prevail at the circuit court level.

According to Ciolko, the courts that have found no standing for former employees have done so by construing the alleged plan losses flowing from imprudent investment as “unascertainable” damages and not lost benefits. The “plain reading of the statute makes clear that diminution of plan assets and lost growth directly affect the benefits of plan participants. Calculation of the direct diminution—and the benefits that should have been available under a prudently invested plan—are inarguably calculable once an imprudence period is established and plan investment data is provided, with a little assistance from investment experts,” Ciolko said.

Ciolko also added that it is “painfully ironic that, as the country’s largest corporations increasingly turn to 401(k)s as the sole/primary vehicle for providing retirement benefits to their employees, a number of courts have found that those same employees can be foreclosed from relief from fiduciary breaches that significantly reduce those benefits merely because they have reached retirement age and took their diminished benefit amounts before they knew a breach had occurred.”

Ron Dean, a plaintiffs’ attorney from Pacific Palisades, Calif., told BNA Jan. 5 that some courts have “severely restricted available remedies against breaching fiduciaries” by restricting the standing of those that complain about such breaches.

“Some trial courts recently have held that if a plan distributes to a participant what the plan believes to be

the participant’s benefits, the participant no longer has standing to challenge that distribution. Nowhere else in the law do we see courts going to such lengths to protect wrongdoers as we see in the ERISA scheme and it’s all done with the philosophy that if we don’t allow fiduciaries this discretion then employers won’t set up pension plans in the first place,” Dean said.

## ‘Stock Drop’ Cases

Like in the past several years, employer stock cases have permeated the ERISA landscape. Many of the “stock drop” cases as they are often referred to have either been settling or have been dismissed at the early stages of litigation. But a large percentage of the stock drop cases have recently survived motions to dismiss and are proceeding in federal courts throughout the country.

Those cases that have survived dismissal often go on to settle with no admission of liability on the part of the defendant plan fiduciaries.

**Notable Settlements.** Some significant settlements of stock drop cases include:

- A \$134 million settlement in the Department of Labor’s civil action against former fiduciaries of Enron Corp.’s retirement plan. The settlement received court approval in February (*Chao v. Enron*, S.D. Tex., No. H-03-2257, settlement approval announced 2/16/06; 33 BPR 554, 2/28/06). A few months earlier, the court approved a partial settlement in a separate lawsuit by retirees and former employees of Enron. That settlement called for the payment of \$85 million out of two fiduciary liability policies (103 PBD, 5/31/05; 32 BPR 1258, 6/7/05).

- An \$11.75 million settlement between Kmart employees and the company’s directors over the investment of employee pension funds in Kmart stock. The settlement received final court approval in June and is to be divided among class members who participated in Kmart’s 401(k) plans and who purchased, sold, or held Kmart stock between March 15, 1999, and May 6, 2003. Over 100,000 class members were to receive distributions from the settlement (*Rankin v. Rots*, 38 EBC 1501 (E.D. Mich. 2006)(127 PBD, 7/5/06; 33 BPR 1633, 7/11/06)).

- A federal court in New York approved a \$100 million settlement that ended a lawsuit against AOL Time Warner Inc. by participants in the company’s 401(k) plan. The court noted that the settlement was one of the largest ERISA settlements to date and would be distributed to some 65,000 class members, many of whom have already received payment under a \$2.65 billion settlement reached in a securities class action against AOL Time Warner (*In re AOL Time Warner ERISA Litigation*, 39 EBC 1031 (S.D.N.Y. 2006)(191 PBD, 10/4/06; 33 BPR 2425, 10/10/06)).

- A federal court in Kansas approved a settlement that could reach as high as \$25 million in a lawsuit alleging Sprint Corp. and its directors breached their fiduciary duties by investing 401(k) plan assets in Sprint stock when it was an imprudent investment. The settlement called for a one-time cash payment of \$4 million to class members, which would amount to \$63 per person when divided among the 63,275 class members. In addition, the settlement required Sprint to increase its matching contributions in the 401(k) plan and provide

financial planning services to its employees (*In re Sprint Corp. ERISA Litigation*, (D. Kan. 2006)(161 PBD, 8/22/06; 33 BPR 2051, 8/20/06)).

**A Decision on the Merits.** One stock drop case reached trial and was decided on its merits. After conducting a six-day bench trial, a federal court in Virginia ruled that US Airways Inc. did not breach its ERISA fiduciary duties by failing to remove its stock as a retirement investment option for its employees during a period leading up to the company's bankruptcy (*DiFelice v. US Airways Inc.*, 436 F. Supp. 2d 756, 38 EBC 1072 (E.D. Va. 2006)(125 PBD, 6/29/06; 33 BPR 1581, 7/4/06)).

Using the "portfolio management theory," the court said US Airways offered its employees at least 13 plan investment options and, while the company's stock was a high-risk investment, participants were offered other low-risk investment options. The portfolio management theory instructs that because the risks of different investments are not perfectly correlated, the risks of a portfolio seeking a given return can be minimized by diversifying the investments within a portfolio, the court said.

Moreover, the court said US Airways' bleak financial condition had been publicly disclosed and the company had repeatedly advised its employees to diversify their plan accounts. According to the court, if a 401(k) plan "offers participants a broad array of investment choices, one of which is a relatively risky option to invest in employer securities, the fiduciary should not be deemed to have violated any fiduciary duty for offering this option provided the investment in company stock remains viable, and the company has fully disclosed to participants the risks attendant in that investment."

**The Future of Stock Drop Cases.** According to attorney Robert Rachal of Proskauer Rose, New Orleans, the US Airways decision indicates that it will be "tough to prove stock drop claims based on the notion that the company's stock was inherently prudent."

"How claims based on the notion the stock was fraudulently inflated will play out, both on liability and what the remedy shall be, is still to be determined. There has, however, been a definite downturn in the number of filings of stock drop claims, likely driven by numerous factors, including improving fiduciary oversight, less company stock being held in plans, and the fact that stock prices have generally risen over the past few years. The diversification provisions for company stock required by the 2006 PPA also ought to lessen claims going forward," Rachal told BNA Jan. 5.

## Retiree Health Benefits

The year 2006 saw several cases dealing with employers' right to modify, amend, or terminate the health benefits of their retirees. Unlike pension benefits that are protected by ERISA's anti-cutback rule, welfare benefits are not protected by the rule and therefore employers are often able to modify, amend, or terminate such benefits at any time.

Welfare benefits such as retiree health benefits cannot, however, be modified, amended, or terminated if the employer expressed an intent to vest such benefits. Throughout 2006, federal courts throughout the country issued numerous decisions finding both for and against retirees who claimed they were entitled to lifetime retiree health benefits.

**Cases That Found Benefits Vested.** The following is a summary of cases where courts found that retirees had vested health benefits that could not be modified, amended, or terminated by the employer:

- The Sixth Circuit upheld a federal district court's injunction that required fully employer-paid health insurance benefits be restored to thousands of Case Corp. workers who retired prior to Oct. 3, 1993 (*Yolton v. El Paso Tennessee Pipeline Co.*, 435 F.3d 571, 36 EBC 2217 (6th Cir. 2006)(11 PBD, 1/18/06; 33 BPR 264, 1/24/06)). The appeals court agreed with the lower court that Case and its predecessors intended to provide free lifetime health benefits to retirees as evidenced through a series of collective bargaining agreements that linked health benefits to the retirees' pension benefits.

- A federal trial court in Michigan ordered automobile parts manufacturer ArvinMeritor Inc. to reinstate health benefits for its 2,900 retirees and their dependents and surviving spouses (*Cole v. ArvinMeritor Inc.*, 37 EBC 1732 (E.D. Mich. 2006)(167 PBD, 8/30/06; 33 BPR 2100, 9/5/06)). Among other things, the court rejected ArvinMeritor's contention that retirees' health benefits were durational instead of lifetime and lasted only during the life of each three-year collective bargaining agreement between ArvinMeritor's parent company and the United Auto Workers.

- The U.S. Court of Appeals for the Fifth Circuit ruled that Halliburton Co. breached the terms of a merger agreement with Dresser Industries Inc. when it made modifications to a health plan for retirees of Dresser without making similar modifications to Halliburton's health plan for active employees (*Halliburton Co. Benefits Committee v. Graves*, 463 F.3d 360, 38 EBC 2249 (5th Cir. 2006)(169 PBD, 9/1/06; 33 BPR 2094, 9/5/06)). The Fifth Circuit rejected Halliburton's argument that the retirees could not enforce any provision of the merger agreement, such as the provision that allowed Halliburton to amend Dresser's plan so long as it made similar amendments to Halliburton's plan for active retirees.

- In September, the Seventh Circuit ruled that Pabst Brewing Co. may have violated the terms of a 1981 shutdown agreement when it made modifications in 2004 to the prescription drug benefits provided to workers who retired under the 1981 agreement (*Zielinski v. Pabst Brewing Co.*, 463 F.3d 615, 38 EBC 2418 (7th Cir. 2006)(174 PBD, 9/11/06; 33 BPR 2177, 9/12/06)). According to the appeals court, the 1981 shutdown agreement contained no termination date and thus the retirees had vested benefits.

- A federal court in Ohio issued an injunction barring AK Steel Corp. from going through with its plans to reduce health benefits for some 4,500 retirees and their spouses (*Bailey v. AK Steel Corp.*, 38 EBC 2876 (S.D. Ohio 2006)(187 PBD, 9/28/06; 33 BPR 2356, 10/3/06)). The court said the retirees were likely to succeed on the merits of their claim that they had vested, lifetime benefits that could not be modified or terminated by AK Steel. Among other things, the court noted that the retirees' health benefits were linked to their pension status.

- A court in the Northern District of California issued a preliminary injunction that requires Rexam Inc. to reinstate the medical and prescription drug benefits for its retirees in three states (*Angotti v. Rexam Inc.*, 38 EBC 1333 (N.D. Cal. 2006)(125 PBD, 6/29/06; 33 BPR 1592, 7/4/06)). The decision is at odds with an opinion

issued later in the year by a Minnesota court that refused to issue a similar injunction for Rexam retirees in other states.

**Cases That Found No Vesting of Benefits.** In the following cases, the federal courts found that retirees did not have vested health benefits and thus the employer would not run afoul of ERISA by modifying, amending, or terminating the benefits:

- The Second Circuit ruled in March that union retirees of the New York City Transit Authority were not entitled to lifetime health benefits under a plan sponsored by their union because they lacked a vested right to such benefits (*Bouboulis v. Transport Workers Union of America*, 442 F.3d 55, 37 EBC 1007 (2d Cir. 2006) (51 PBD, 3/16/06; 33 BPR 741, 3/21/06)). The appeals court noted that although a summary plan description was silent as to whether the union had the right to modify or terminate its retiree health plan, this silence could not be read as a promise that the retirees' benefits were vested.

- In two decisions issued by the U.S. Court of Appeals for the First Circuit, the appeals court ruled that the energy firm NSTAR Electric and Gas Corp. did not violate the Labor Management Relations Act or ERISA by amending its retiree dental benefit plans for retired union and nonunion workers once they reached the age of 65 (*Senior v. NSTAR Electric and Gas Corp.*, 449 F.3d 206, 37 EBC 2409 (1st Cir. 2006) (106 PBD, 6/2/06; 33 BPR 1364, 6/6/06); *Balestracci v. NSTAR Electric and Gas Corp.*, 449 F.3d 224, 37 EBC 2422 (1st Cir. 2006) (106 PBD, 6/2/06; 33 BPR 1364, 6/6/06)). In both cases, the appeals court said it was rejecting a "presumption against vesting" that as been adopted by other federal courts that have found there can never be vesting of retiree welfare benefits unless there is a "clear and express statement" of such vesting.

- A federal court in West Virginia ruled that a group of ACF Industries LLC retirees were not entitled to unchangeable, lifetime health benefits under a series of collective bargaining agreements between ACF and the United Steelworkers of America (*Chapman v. ACF Industries LLC*, 38 EBC 2035 (S.D. W.Va. 2006) (91 PBD, 5/11/06; 33 BPR 1247, 5/16/06)). The court found that the bargaining agreements, along with contemporane-

ously created insurance agreements, were unambiguous and did not provide vested health benefits.

- In October, a federal district court in Minnesota refused to issue a preliminary injunction barring beverage can manufacturer Rexam Inc. from discontinuing medical and prescription drug benefits for Medicare-eligible retirees (*Angotti v. Rexam Inc.*, 38 EBC 2775 (D. Minn. 2006) (209 PBD, 10/31/06; 33 BPR 2641, 11/7/06)). The court said that while the relevant bargaining agreement between the International Association of Machinists and Rexam stated that retirees' health benefits would "discontinue upon death," this was insufficient evidence that the retirees had vested benefits given that other provisions in the bargaining agreements gave Rexam the right to modify or terminate such benefits.

## Outlook for 2007

As seen by the growing divide among the federal trial courts on the issues of cash balance plans and former employee standing, the year 2007 should prove to be a very active year in the federal appeals courts on these two issues.

In addition, there could be several decisions in the employer stock drop cases that were dismissed at the summary judgment stage. According to Ondrasik, there has been a "new wave" of stock drop cases that differ from the original cases, filed shortly after the collapse of Enron Corp. and WorldCom Inc. The original cases dealt with corporate meltdowns, but now the claims are often against vital companies.

"The new wave of cases will put plaintiffs' claims to the test," Ondrasik said, adding that many of the cases are basic securities fraud case filed under the guise of ERISA.

To date, the Supreme Court in its current term has not yet granted certiorari in any ERISA case. Several petitions for certiorari are currently pending with the Supreme Court, including a petition in the *IBM* case. If the high court declines to review the *IBM* case, the issue of cash balance plans and age discrimination could still reach the Supreme Court this year or next if either the Second Circuit or the Sixth Circuit disagree with the Seventh Circuit and find that cash balance plans are age discriminatory.

BY JO-EL J. MEYER