A Timely Analysis of Legal Developments

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Tenth Circuit is First Circuit to Determine Remedies for Violation of ERISA Section 204(h) Notice Requirements

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The transition of many companies from using traditional "final average pay" plans to "cash balance" pension plans in the last two decades has created significant employee discontent, and therefore substantial litigation. Unfortunately, the courts have been anything but uniform in determining what plaintiffs must prove in order to obtain the remedies they seek under the Employee Retirement Income Security Act of 1974 (ERISA). Adding some clarity to this murky area of law is the Tenth Circuit's July 2, 2013 decision *Jensen v. Solvay Chemicals, Inc.*, No. 11-8092. In *Solvay* the Tenth Circuit clarifies what it means for a deficient 204(h) notice to be "egregiously" deficient, and explains that an equitable estoppel remedy is not available to plaintiffs unless they can demonstrate actual harm and reliance.

The Problem of the Cash Balance Plan's "Wear-Away" Period and the Notice Requirements of ERISA §204(h)

A cash balance plan is a form of defined benefit plan. The cash balance plan formula is calculated based on annual "pay credits" (a percentage of an employee's current year earnings) plus "interest credits" on the existing balance. This formula differs from a traditional defined benefit plan, which typically provides for an annual benefit calculated by taking a percentage of the employee's average annual pay at the end of employment and multiplying that by the employee's years of service at retirement.

In recent decades, cash balance plans have been favored by employers because they are easier for employees to understand and lead to more predictable contributions for employers. From the employee's perspective, however, cash balance plans may be less desirable for longer-service employees because the benefit accrues more rapidly in the earlier years of employment and more slowly in the later years.

When a plan is converted from a traditional formula to a cash balance formula, the plan must offer, as a minimum benefit, the employee's retirement benefit under the old formula, frozen as of the date of conversion (but counting post-conversion service for early retirement eligibility). In Solvay's case, the old formula provided an unreduced benefit if an employee retired at or after age 55, with age and service totaling 85 points. Because the cash balance plan started out with the value of an employee's age 65 benefit, an employee eligible for the unreduced early retirement benefit might not see any increased benefit accrual under the cash balance formula, because the frozen benefit

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(unreduced) was more valuable than the retirement-date cash balance benefit (reduced for early retirement).

Section 204(h) of ERISA requires a disclosure of any plan amendment that provides for a significant reduction in the rate of future benefit accrual (for the normal retirement benefit), or if there is a significant reduction in an early retirement subsidy or early retirement benefit. The disclosure must describe in detail the old formula and the new formula so that an employee can determine the impact of the amendment on his or her future benefits. If the failure to make the disclosure, or any inadequacy in the disclosure, is "egregious," then employees are entitled to enhanced benefits as though the plan had never been amended and the old formula continued to apply.

Litigation Background

In 2006, current and former employees sued Solvay and the plan alleging that Solvay's conversion to the cash-balance formula violated ERISA and the Age Discrimination in Employment Act of 1967 (ADEA). Solvay sought summary judgment on plaintiffs' six claims, and the U.S. District Court for the District of Wyoming granted Solvay's motion. Plaintiffs then appealed to the Tenth Circuit on the following claims: (1) failure to make adequate disclosures under ERISA §204(h); (2) failure to make adequate disclosures under ERISA §102 and violation of fiduciary duties imposed by §404(a)(1); and (3) age discrimination under §4(a) of the ADEA because of the consequence of the wear-away effect on older employees.

On appeal, the Tenth Circuit largely affirmed the district court but held that Solvay's §204(h) notice was deficient in only one respect – it failed to describe the method for calculating early retirement benefits under the old plan (even though the notice included an example of an employee whose early retirement benefit did not increase for a six-year period). Despite the notice's deficiency, the Tenth Circuit noted that whether plaintiffs are entitled to benefits under the old formula depends on whether there was an "egregious failure" in Solvay's notice. *See* 29 U.S.C. § 1054(h)(6)(A). The Tenth Circuit therefore remanded the case back to the district court to determine whether Solvay's failure was "egregious."

Under ERISA, a company's failure is "egregious" if: (1) the failure was "within [its] control" and was "intentional," or (2) if the failure was "within its control" and the company failed to "promptly provide the required notice or information after [it] discover[ed] an unintentional failure to meet the requirements" of §204(h).[1] Following a bench trial on remand, the district court determined that Solvay's failure was not egregious under either statutory definition. Plaintiffs then appealed that decision to the Tenth Circuit.

Tenth Circuit's July 2, 2013 Decision Provides Guidance on Notice Requirements and Equitable Remedies

On appeal, plaintiffs argued that to recover the benefits promised under the old plan, they must show only that Solvay intentionally included the language describing (or failing to describe) the benefits in the old and new formulas and that those disclosures failed to satisfy the requirements of the statute. In rejecting plaintiffs' argument, the Tenth Circuit clarified the standard that plaintiffs must meet, and it appears that the Tenth Circuit is the first to do so.

The Tenth Circuit found that even under the "intentional" definition the plaintiffs proposed, Solvay "wanted to make all disclosures the law required, that the company's omission was *accidental*, no more than an oversight in the process of drafting a complex statutorily mandated notice." The Tenth Circuit relied specifically on the testimony of Solvay executives that there was no intention to leave out details, as well as on the testimony of outside lawyers and actuaries that they were directed to ensure that the §204(h) notice contained everything required by law. They explained that they were under no instruction to hide anything from employees, and that they did not receive any pushback from Solvay executives concerning their recommended text for the 204(h) notice. On that basis, the Tenth Circuit held that plaintiffs had no path to relief under §204(h) because they could not demonstrate that the disclosure failure was "egregious." The Tenth Circuit was also persuaded that Solvay did not discover its failure until after litigation began, and immediately thereafter sought to correct the error.

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1 An egregious failure can also include a failure to provide most of the affected individuals with the notice, but this aspect was not at issue in the *Solvay* case.

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The plaintiffs alternatively sought to obtain the benefit of the old formula (for future benefit accruals) in the form of equitable relief for Solvay's incomplete disclosures in its "summary of material modifications" (which, they argued, violated ERISA §102(a)).[2] In analyzing that claim, the Tenth Circuit noted that in order to obtain promissory estoppel under section 502(a)(3) of ERISA, plaintiffs must show actual reliance. The court clarified that "we know that plaintiffs who seek the remedy of estoppel must demonstrate that the defendant's statements in truth, influenced the conduct of the plaintiff, causing prejudice" (internal citations omitted). Accordingly, the court reasoned that "[i]n light of all this, we know at the very least that the employees in our case cannot obtain an estoppel remedy. The district court found that Solvay's deficiency *did not* influence their conduct because they already knew they were losing benefits under the new plan." Without proof of actual harm to the plaintiffs and actual reliance on the deficient disclosure, plaintiffs could not obtain equitable relief for promissory estoppel. Because the plaintiffs had not articulated any other basis for equitable relief for the asserted violation of §102(a), the Tenth Circuit affirmed the district court's determination.

Conclusion

The consequences of failing to provide proper disclosures under ERISA can be extreme. Employers should be mindful of ERISA's complex set of requirements and comply with them fully. In doing so, employers should direct the lawyers charged with preparing disclosures to comply with the law fully, and should be cautious about removing accurate disclosures from drafts, given the consequences that could result in the event the disclosures are later found to be incomplete.

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2 ERISA §102(a) requires a notice of material modifications when a plan is amended in any material respects. This notice can be provided up to 210 days after the end of the plan year in which the amendment is adopted. *See* ERISA §104(b)(1)(B). Solvay intended its §204(h) notice to also satisfy its obligation to provide a summary of material modifications, and the plaintiffs argued that any deficiency in the §204(h) notice, by definition, constituted a deficiency in the summary of material modification rules as well.

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