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The Supreme Court Considers the Standards Governing the Interpretation of ERISA Plans

January 21, 2010

The United States Supreme Court heard oral arguments yesterday in *Conkright v. Frommert*, No. 08-810, in which the Court has been asked to consider the proper standard of review that applies to an interpretation of a plan covered by the Employee Retirement Income Security Act (“ERISA”). Specifically, the Court is faced with the questions of: (1) whether courts must defer to a plan administrator’s interpretation of an ERISA plan outside the context of an administrative claim for benefits; and (2) whether a district court’s interpretation of plan terms should be reviewed only for abuse of discretion if the court interprets the plan in remedying an ERISA violation.

BACKGROUND

Conkright was brought by certain plan participants seeking a recalculation of their benefits under the company’s retirement plan. After departing Xerox Corporation (“Xerox”) and receiving lump sum distributions of their retirement benefits under the Xerox Corporation Retirement Income Guarantee Plan (the “Plan”), certain employees were rehired by Xerox. A dispute then arose over how the previously-distributed payments should be factored into the calculation of their new retirement benefits after returning to Xerox.

Under the Plan, the benefit formulas were tied to the employees’ years of service with the company. The Plan included two provisions to avoid paying a windfall to rehired employees: (1) the “non-duplication” provision required an “offset by the accrued benefit attributable to such distribution”; and (2) a “phantom account” provision providing a specific method by which the Plan Administrator could offset a rehired employee’s benefits. Under the phantom account provision, the offset was calculated by determining the benefits Plaintiffs would have received from such distribution had they not received it previously, and subtracting such amount from the total earned benefits based solely on the number of years employed by the company. Notably, while the language describing the phantom account offset was contained in prior versions of the Plan, the Restatement issued by Xerox in 1989 failed to contain any explicit mention of this mechanism. In 1998, the Plan was amended to reinstate the phantom account language.

When the rehired employees learned that the phantom account offset would be applied to their benefits, they sought clarification from Xerox. During the administrative review process that followed, Xerox maintained that, while the absence of the phantom account language from the Plan in 1989 was a mistake, the phantom account offset mechanism had continuously been in effect since its inception in 1977.

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In November 1999, after exhausting all administrative remedies, the rehired employees, Plaintiffs-Respondents, filed suit against Xerox and the Plan Administrators, Defendants-Petitioners, claiming that the use of the phantom account offset in calculating their benefits violated ERISA. The district court agreed with Xerox that the Plan had always, explicitly or implicitly, provided for the phantom account offset, and the 1998 amendments to the Plan simply made express what had been implied in the language of previous plans. The court upheld the use of the phantom account offset and granted summary judgment to Xerox.

On appeal, the Second Circuit disagreed. The Court of Appeals found that the Plan had not contained the phantom account offset as it was amended in 1998. Accordingly, the court held that the application of that provision to employees rehired before 1998 constituted a violation of ERISA because it was an impermissible retroactive cut-back of benefits. The Second Circuit remanded the case to the district court to employ equitable principles in determining an appropriate offset calculation for employees rehired prior to 1998 based on the Plan then in effect.

On remand, the district court acknowledged that instead of having been tasked with writing a "sound retirement plan," the court had been charged with interpreting the Plan as written. Where there was ambiguity as to the method of calculating the proper offset amount, the court reasoned, it should be Xerox and not the employees who should suffer. Framing the issue as "what a reasonable employee would have understood to be the case concerning the effect of prior distributions," the court rejected the proposals of the Administrators and adopted a method proposed by Plaintiffs by which the prior distributions would be subtracted from a rehired employee's benefits without any upward adjustment.

In its second review, the Second Circuit upheld the district court's chosen remedy under an "excess of allowable discretion" standard of review. In addressing Xerox's claim that the district court erred in not considering the Plan Administrator's proposal under a deferential standard of review, the Second Circuit stated that the district court had no decision to review in the present case—the Plan Administrator had never rendered a decision after the original benefit determination, which was found to have violated ERISA. The Plan Administrator had simply proposed an alternative interpretation at a hearing in the district court after the Second Circuit rejected its original interpretation as a violation of ERISA. The court stated that there had been presented "no authority in support of the proposition that a district court must afford deference to the mere opinion of the plan administrator in a case, such as this, where the administrator had previously construed the same terms and we found such a construction to have violated ERISA." 535 F.3d 111, 119 (2nd Cir. 2008).

On June 29, 2009, the Court granted the Xerox's petition for writ of certiorari. Justice Sotomayor recused herself, having sat on the Second Circuit panel that issued the decision on appeal.

SUMMARY OF THE ARGUMENT

In requesting that the Supreme Court reverse the Second Circuit's decision during yesterday's oral arguments, Xerox argued that a plan administrator's interpretation should be upheld by a court so long as the plan administrator is not acting in bad faith or outside of the boundaries of his discretion. Xerox maintained that its interpretation here was grounded in the language of the Plan, properly recognized the

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JUSTICE ALITO

time value of money, and thus avoided a result where the Plaintiffs would receive a windfall.

Justice Alito asked how many opportunities plan administrators should be afforded to render a valid interpretation: "[I]f there's no bad faith, then how many shots does the plan administrator . . . get[] to try to answer this question?"

Justice Ginsburg then commented that the flaw in the Plan Administrators' interpretation was not simply an underlying error in the phantom offset the Administrator sought to employ, but rather a violation of ERISA's notice and anti-cutback provisions. "[W]hat I took away from the Second Circuit's opinion was the flaw here was not that the method was no good if you had adequate notice." In response, Xerox argued that, although its original interpretation was rejected by the Second Circuit based on inadequate notice, its interpretation on remand was significantly different and not necessarily fatally flawed in the same way.

A significant portion of Xerox's argument time was taken up by Justices Ginsburg and Scalia questioning regarding how, when, and where the phantom offset provisions appeared in the Plan.

The Plaintiffs argued that there is no requirement for lower courts to defer to plan administrators after they have been given an opportunity to render a valid interpretation and failed. While admitting that district courts in such circumstances may choose to defer to administrators, Plaintiffs contended that the egregiousness of Xerox's errors in this case warranted the district court's decision not to afford deference to the Plan Administrator's second proffered interpretation.

Chief Justice Roberts questioned Plaintiffs regarding the incentives their proposed rule would create for plan administrators, namely putting forth as many possible interpretations of the plan initially. "You want the administrators to give the most reasonable interpretation, but under the logic of letting them be able to put the first interpretation there, they could just put a list of ten interpretations, starting with the one that is most favorable." Justice Alito followed by asking Plaintiffs what factors should be used to determine when a plan administrator is entitled to a second chance at interpreting a plan.

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CHIEF JUSTICE ROBERTS

In posing a hypothetical to Plaintiffs, Justice Breyer inquired what was improper about placing rehired employees on the same footing as employees who had worked for the same amount of time, but had stayed with Xerox and never received a payout. Plaintiffs contended that the Xerox employees were provided with inaccurate disclosures of their benefits for five years.

In support of affirmation of the Second Circuit's decision, the United States argued that deference to the Plan Administrator would have been inappropriate in this case because the Plan Administrator's second interpretation offered on remand at the district court would have presented the same notice problems under ERISA as the Administrator's original interpretation rejected by the Second Circuit. Justice Scalia questioned the Government regarding the systemic consequences of not deferring to plan administrators. "[I]f we accept your argument, if other retirees, who are later rehired, bring a lawsuit in another court, you might have a different result because it would be up to the court to decide what was a proper result, right?" The Government replied that this was an unusual case requiring the district court's substitution of its own interpretation of

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JUSTICE GINSBURG

the Plan over that of the Plan Administrator to remedy a fundamental notice flaw prohibited under ERISA.

In rebuttal, Xerox emphasized the windfall that would befall Plaintiffs if the district court's interpretation was upheld. Justice Ginsburg again referenced the notice issue and questioned Xerox regarding the periodic statements that Plaintiffs received that provided inaccurate benefits calculations under the Plan Administrator's interpretation of the Plan. "[W]hy did [the employee] get notices that gave him the perception he was going to get over 2,000 when it was so much less?" Xerox responded that such notifications were not plan documents and contained language indicating that benefits may be less than what appeared on the statement.

IMPLICATIONS

In *Conkright v. Frommert*, the Court has the opportunity to provide guidance on the proper standard of review governing the interpretation of an ERISA plan beyond the context of an administrative claim for benefits. If the Court were to agree with the Plan and Administrators, the Court would bolster the authority of a plan administrator to construe the terms of an ERISA plan. On the other hand, if the Court were to find for the rehired employees, the Court would facilitate plan participants' ability to attack the interpretation of plan administrators as inconsistent with the terms of the plan.

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