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The Supreme Court Requires Deference to Plan Administrator's Interpretation of ERISA Plan Notwithstanding Administrator's Prior Invalid Interpretation

April 23, 2010

In *Conkright v. Frommert*, No. 08-810, issued on April 21, the United States Supreme Court addressed the proper standard of review that applies to a plan administrator's interpretation of a plan covered by the Employee Retirement Income Security Act ("ERISA"). Specifically at issue was the extent to which courts must defer to a plan administrator's interpretation of an ERISA plan when the administrator's prior interpretation was found to be invalid.[1] The Court held 5-3 that the Court of Appeals for the Second Circuit erred in allowing the district court to decline to defer to the plan administrator's interpretation of the plan at issue simply because a previous related interpretation by the administrator was found to be invalid. In its decision, authored by Chief Justice Roberts, the Court rejected a "one-strike-and-you're out" approach under which administrators would only be entitled to deference in connection with their initial interpretations of ERISA plans.

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 the rehired employees' new retirement benefits.

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. First, the "non-duplication" provision provided that the pension floor would be offset by the accrued benefit attributable to the lump sum distribution previously received by a rehired employee. In other words, to avoid double counting, the lump sum amount the re-hired employee previously received was subtracted from that employee's benefit amount under the Plan. Second, in order to factor in the time value of money, the

[1] The Court did not reach a second raised by the case: whether the district court's decision should have been reviewed by the Court of Appeals under an "abuse of discretion" standard.

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"phantom account" provision provided a specific method by which the Plan Administrator could offset a rehired employee's benefits to reflect the fact that such employee previously received lump sum benefits from the Plan prior to retirement. 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.

After receiving notice of the 1998 amendments and learning that the phantom account offset would be applied to their benefits, the rehired employees sought clarification of their benefits 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.

In November 1999, after exhausting their 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. Judge Larimer upheld the use of the phantom account offset and granted summary judgment to Xerox. 206 F. Supp. 2d 435 (W.D.N.Y. 2002).

On appeal, the Second Circuit reversed. 433 F.3d 254 (2d Cir. 2006). The Court of Appeals found that the Plan had not contained the phantom account offset until 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 stated that it had not been tasked with writing a "sound retirement plan." Rather, the court concluded that it 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 reflecting the time value of money. 472 F. Supp. 2d 452, 457 (W.D.N.Y. 2007).

In the appeal that followed, the Second Circuit unanimously affirmed the district court's chosen remedy under an "excess of allowable discretion" standard of review. 535 F.3d 111, 117 (2d Cir. 2008). In addressing Xerox's claim that the district court erred in not considering the Plan Administrator's proposal under a deferential standard, 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." *Id.* at 119.

On June 29, 2009, the Court granted 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 DECISION

In its opinion, written by Chief Justice Roberts and joined by Justices Scalia, Kennedy, Thomas, and Alito, the Supreme Court presented the question at issue as whether "a single honest mistake in plan interpretation justifies stripping the administrator of that deference for subsequent related interpretations of the plan." Holding that it does not, the Court reversed the judgment of the Court of Appeals of the Second Circuit and remanded the case for further proceedings consistent with its opinion.

"If . . . a systemic conflict of interest does not strip a plan administrator of deference, it is difficult to see why a single honest mistake would require a different result."

OPINION OF THE COURT

The Court began by addressing the standard for reviewing interpretations by ERISA plan administrators established in prior cases. Discussing *Firestone Tire & Rubber Co. v. Bruch*, 480 U.S. 101 (1989), and *Metropolitan Life Ins. Co. v. Glenn*, 554 U.S. __ (2008), the Court noted that, "when the terms of a plan grant discretionary authority to the plan administrator, a deferential standard of review remains appropriate even in the face of a conflict." The Court concluded that, while the Plan Administrator here "would normally be entitled to deference when interpreting the Plan," the Second Circuit's decision "crafted an exception to *Firestone* deference."

The Supreme Court rejected this "one-strike-and-you're out" exception, finding that such an approach "has no basis in the Court's holding in *Firestone*." The Court reasoned: "[i]f, as we held in *Glenn*, a systemic conflict of interest does not strip a plan administrator of deference, it is difficult to see why a single honest mistake would require a different result."

The Court further noted that the Second Circuit's decision is not supported by "the considerations on which our holdings in *Firestone* and *Glenn* were based—namely, the terms of the plan, principles of trust law, and the purposes of ERISA." First, the Court continued, "[n]othing in that provision suggests that the grant of authority is limited to first efforts to construe the Plan." Second, the Court reasoned that the Court of Appeals' holding was not required by principles of trust law, especially where "the lower courts made no finding that the Plan Administrator had acted in bad faith or would not fairly exercise his discretion to interpret the terms of the Plan." Third, although it concluded that "trust law does not resolve the specific issue before us," the Court found that "the guiding principles we have identified underlying ERISA do." The Court thus held that the district court should have granted deference to the Plan Administrator's interpretation, reasoning that providing deference under such circumstances would promote efficiency, predictability, and uniformity.

"Here trust law does not resolve the specific issue before us, but the guiding principles we have identified underlying ERISA do."

OPINION OF THE COURT

The Court rejected the argument advanced by respondents and the Government that "continued deference would encourage plan administrators to adopt unreasonable interpretations of plans in the first instance," "thereby undermining the prompt resolution of disputes, driving up litigation costs, and discouraging employees from

challenging the decisions of plan administrators at all." Dismissing this concern, the Court concluded that: "[t]here is no reason to think that deference would be required in the extreme circumstances that respondents foresee." The Court observed that multiple erroneous interpretations, even if made in good faith, may warrant finding a plan administrator unable to exercise discretion fairly.

Trust law provides that "a court may (but need not) exercise its own discretion rather than defer to a trustee's interpretation of trust language."

JUSTICE BREYER, dissenting

Justice Breyer authored the dissenting opinion, which was joined by Justices Stevens and Ginsburg. The dissent argued that the Court erred in finding that trust law does not resolve the specific issue before the Court. According to the dissent, under the circumstances presented in this case, trust law provides that "a court *may* (but need not) exercise its own discretion rather than defer to a trustee's interpretation of trust language." The dissent also questioned whether "the Court's legal rule reflects an appropriate analysis of ERISA-based policy," noting that the rule may delay proceedings and creates incentives for administrators to take "'one free shot' at employer-favorable plan interpretations." The dissent thus would have allowed "the supervising court the decision as to how much weight to give to a plan administrator's remedial opinion."

The dissent also addressed the question of whether the Second Circuit used the proper standard to review the district court's decision. Finding that the Second Circuit treated the district court opinion as fashioning an equitable remedy, the dissent concluded that the Second Circuit properly reviewed the decision for an "abuse of discretion."

IMPLICATIONS

In *Conkright*, a majority of the Court held that a district court may not substitute its own judgment in interpreting language of an ERISA plan for that of a plan administrator simply because of a prior related interpretation by the administrator was invalid. Under the decision, lower courts may be wary of replacing their own interpretations for those of administrators absent any finding that the administrator was acting in bad faith or unable to fairly exercise its discretion in interpreting an ERISA plan.

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