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# Briefly on Benefits (December 2009)

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**To Err is Human; To Forgive is a Relief - Court Reforms Plan for Drafting Error**
by Mark Bongard

In a 106 page decision, the Federal District Court in *Young v. Verizon's Bell Atlantic Cash Balance Plan*, N.D. Ill., No. 05 C 7314, November 2, 2009 applied the equitable doctrine of reformation to correct a scrivener's error in the plan document. Had the error stood, the plaintiff class would have received more than $1 billion in additional plan benefits. This decision illustrates the narrow circumstances under which a written ERISA plan can be corrected for a drafting error.

Facts

The plan at issue started as a traditional defined benefit pension plan. Effective January 1, 1996, the plan was converted to a cash balance pension formula.

A national actuarial firm was retained to convert the plan from a traditional defined benefit plan to a cash balance plan. The Plan's actuary conducted studies and produced a formula for calculating opening plan balances under the cash balance formula. In general, participants' benefits would be converted to a lump sum cash out value at the date of plan conversion. These lump sum values would then be multiplied by a single transition factor to produce the opening balances.

The Plan's actuary produced the first three drafts of the new plan formula. After that, the company's in-house ERISA attorney took over drafting responsibilities. His drafts inadvertently and erroneously changed the plan formula to include a second multiplication by the transition factor. Therefore, applied literally, the plan would have multiplied a participant's lump sum cash out value by the transition factor two times, which would have resulted in an additional $1.67 billion in opening balances.

The scrivener's error went unnoticed and the plan was adopted with the drafting error intact. All written communications to participants, however, correctly reflected the company's intent to only multiply the lump sum cash out value of the benefit at the date of conversion by a single transition factor. These written communications were in brochures describing the plan changes, a summary of material modifications to the plan and the summary plan description for the plan. Many of them included numerical examples that clearly included a single transition factor for the calculation of opening balances.

Furthermore, the company actually computed plan benefits using a single transition factor. There were no complaints from participants regarding these calculations. After all, the calculations were in accordance with the participants' expectations based upon all of the written documentation they had received regarding the plan.

Cynthia Young, the plaintiff representing the class of plaintiffs, was a participant in the plan. She retired in 1997 and received a lump sum payment in early 1998.

In 2003, Ms. Young came to believe her benefit payment may have been understated. She sought help from the National Center for Retirement Benefits. With their help, she filed an administrative claim based upon the discount rate used to compute the lump sum cash out value of her benefit at the date of plan conversion. That appeal was denied and she filed suit at the end of 2005. It was not until July of 2006 that she filed leave to amend her complaint to add a claim relating to the failure to multiply her lump sum cash out value by the transition factor twice, as literally provided under the terms of the plan. In January of 2007, the parties stipulated to treat this case as a class action.

As a result of amending the complaint to add the claim referencing the second transition factor, the defendant filed a counterclaim asking that the court apply the doctrine of reformation to correct the scrivener's error.

The Court's Analysis Regarding Reformation of the Plan

At the outset let's state the obvious: this case involves interesting issues relating to the application of the statute of limitations in addition to correcting a drafting error. After all, the plaintiff waited about seven years to file suit and the defendant asserted a counterclaim based on a drafting error committed more than a decade before asserting the counterclaim. Obviously, these hurdles were overcome since the court ruled in favor of the defendant's counterclaim for reformation of the plan document. In brief, the court applied the Pennsylvania four year statute of limitations measured from the date the plaintiff's administrative appeal was denied. The same four year statute of limitations applied to the defendant's counterclaim. However, the court concluded that the limitations period began to accrue with regard to the defendant when the complaint was amended in 2006. Therefore, according to the court, all parties filed their claims and counterclaims within the applicable statute of limitations period.

Once the court overcame the statute of limitations issues, the court had to resolve the tension between the ERISA plan document retirement and the equitable doctrine of reformation to reach its conclusion that reformation was appropriate in this situation. Ordinarily, a plan must be administered according to its written terms.

The defendant's counterclaim was based upon ERISA § 502(a)(3) which provides that a fiduciary may obtain "other appropriate equitable relief" to enforce the terms of the plan. Therefore, the court had to answer the question: Is reformation other appropriate equitable relief? The court was able to answer this question in the affirmative because reformation was a remedy typically available in courts of equity.

The court next explored the basis upon which reformation was available as a remedy in courts of equity. In general, the doctrine of reformation was available when parties to a contract reached a valid agreement but the agreed upon understanding between the parties was not accurately recorded in the written document. To reform a written document based upon a mutual mistake or a scrivener's error, the court had to find there was such an error by clear and convincing evidence.

Next, the court set out to apply the principles of reformation in the context of a pension plan subject to ERISA. The court viewed this being within its purview to develop a federal common law of rights and obligations under plans subject to ERISA. The court framed its analysis focusing on the concepts of:

- mutual mistake of fact;
- reliance;
- course of dealing;
- absurdity of result or windfall; and
- policy considerations.

Application of the equitable principle of contract reformation depended upon a mutual mistake of fact between the parties to the contract. Drafting a pension plan is a unilateral exercise. The participants to be covered are not consulted regarding the terms of the pension. It is a plan sponsor decision and is inherently unilateral in nature. The court overcomes this obstacle by concluding a mistake in the context of a pension plan can be mutual if the employees were sufficiently on notice of the sponsor's actual intent. In this case, there were many written documents provided to participants correctly reflecting the sponsor's intent to use a single transition factor.

The court also placed great probative value on the fact that the plaintiff class did not act in reliance on the drafting error in the plan document. All of the written communications to the employees were based upon a computation using a single transition factor. The plaintiff who filed the action was not even aware of the double use of the transition factor in the plan document until after the lawsuit was filed.

Although not expressly stated in the court's opinion, it appears that the finding of a mutual mistake of fact is integrally related to finding a lack of reliance. If the plaintiffs could have demonstrated reliance on the drafting error in the plan document, it would have been more difficult to show by a clear and convincing standard that the plaintiffs were on notice of the sponsor's actual intent.

The court also found a consistent and longstanding course of dealing in line with the sponsor's intent to only use a single transition factor. Benefit calculations were always made using a single transition factor and the employees did not complain about this methodology (at least until the plaintiff saw the plan document after filing this lawsuit).

The court also placed value in the unexpected windfall that would be experienced by the plaintiffs if the plan's double use of the transition factor were applied. This would greatly increase their benefits beyond their reasonable expectations. In the court's view, such a result would be "absurd."

Finally, the court found policy considerations in favor of finding reformation in this case. Employers are not compelled to adopt plans. If there were no way to correct a drafting mistake, employers would be discouraged from adopting plans. Additionally, an absolute prohibition on reformation as a remedy would undermine the goal of protecting employees' justified expectations of getting only the benefits they are promised. Allowing unintended and unexpected benefits to be paid to one group could be harmful to the remaining employees. In the context of a funded plan, providing greatly increased benefits for some could endanger the plan's ability to financially pay full benefits to the remaining participants.

It is, nonetheless, important to remember that reformation is not a remedy easily obtained. All of the written communications to the participants must accurately and convincingly reflect the plan sponsor's intent. Additionally, it is unknown what might have happened in this case had the plaintiff actually obtained and read the plan document before retiring. If that had occurred, the arguments in favor of mutual mistake of fact and failure of the plaintiff to rely on the double use of the transition factor would have been weakened.

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**Denial of Pension for Independent Contractor Upheld**
by Mark Bongard

Facts

In *Scruggs v. ExxonMobil Pension Plan*, 10th Circuit No. 08-6145, November 9, 2009, the Court upheld a plan administrator's denial of the pension benefits claimed by a putative independent contractor.

Barbara Scruggs worked as a secretary for ExxonMobil for 22 years. She started with Exxon before its merger with Mobil and continued working after the merger until the facility where she worked was closed in 2005.

Ms. Scruggs began her secretarial career through a third party that contracted with Exxon. She later entered into a direct contract arrangement with Exxon and then finished her time with ExxonMobil through a third party. These arrangements all provided she was not eligible for employee benefits with Exxon and ExxonMobil. Nonetheless, when she lost her position, she filed a claim for a pension benefit. The plan administrator, an employee for ExxonMobil, denied the claim. Ms. Scruggs then filed suit.

<u>Administrative Appeal Standard of Review</u>

On appeal, the 10th Circuit analyzed the appropriate standard of review to apply to the plan administrator's denial of benefits. The plan document explicitly granted the plan administrator with discretionary authority to determine eligibility for benefits and to interpret the terms of the plan. Therefore, the plan administrator was entitled to a deferential standard of review. This meant the plan administrator's denial would be upheld unless it was arbitrary and capricious.

Because the plan administrator was an employee of the plan sponsor, the Court determined there was a conflict of interest. As provided by the Supreme Court in *Metropolitan Life Insurance Co. v. Glenn*, 128 S.Ct. 2343 (2008), the Court considered this conflict of interest as a factor when determining whether the denial of benefits was arbitrary and capricious.

The weight of this conflict of interest was minimal because:

- the assessment of the plan administrator's job performance was not based on whether he approved or denied appeals;
- the plan administrator's compensation was not related to his appeals decisions; and
- the financial incentive to deny Ms. Scruggs' appeal was small because the cost of approving it would have been insignificant.

Next, the Court determined whether the plan language at issue was ambiguous. The language is ambiguous if it is reasonably susceptible to more than one meaning or there is uncertainty concerning the meaning of the plan terms.

The plan used several terms that included the word "employee" for determining the individuals eligible to receive benefits. A "covered employee" with sufficient service was eligible for a benefit. A "covered employee" was defined as a "qualifying employee" of a "participating employer." The term "qualifying employee" did not include a "special-agreement person" which was defined as an individual performing service per an agreement. It appears that Ms. Scruggs' arrangement fit within the plan's definition of "special-agreement person." Notwithstanding this seemingly applicable exclusion, the Court concluded that the plan language was ambiguous, primarily because the word "employee" was never defined.

Ms. Scruggs argued that "employee" was intended to refer to a common law employee. The plan administrator contended that the term "employee" was not intended to be used as a legal term of art, but rather it was intended to refer to the group of individuals performing services that reasonable business people would consider to be employees. A reasonable business person would consider individuals performing services to be employees who were paid through the payroll system. Ms. Scruggs was never paid through the payroll system.

The plan administrator offered the following in support of his interpretation:

- The benefit administrative system was designed only to support individuals paid through the payroll system.

- The accounts payable system, through which Ms. Scruggs and other similarly situated individuals were paid, was not designed to track and accumulate the kind of information needed to make benefit payments.
- Benefit communications were only provided to individuals paid through the payroll system.
- In 30 years experience, the plan administrator was not aware of anyone paid through accounts payable that was eligible for benefits.

Apparently, Ms. Scruggs did not submit evidence relating to her potential status as a common law employee. The Court did not make such determination either. In fact, the Court did not feel it necessary to make that determination. ERISA does not prohibit a plan from distinguishing among groups of employees regarding plan participation. Therefore, a plan may designate one group of common law employees as eligible to participate and another group as not eligible to participate. (Note: There are practical limits on the ability of a tax-qualified plan to make such distinctions under the time of participation rules and the minimum coverage rules in Code § 410.)

The Court concluded that the plan administrator’s denial of pension eligibility was not arbitrary and capricious. The plan administrator's application of the plan provisions was reasonable and supported. Therefore, the plan administrator’s denial was upheld.

Lessons Learned

There are several lessons that can be learned from this decision. The first is that the plan document should always explicitly delegate discretionary authority to the plan administrator to determine eligibility, benefit entitlement and interpret the provisions of the plan. This delegation preserves the arbitrary and capricious standard of review for benefit determinations made by the plan administrator. Second, if the plan administrator is subject to a potential conflict of interest, take steps to separate the plan administrator from the financial consequences of benefit decisions. Third, it is important to define the basic terms of the plan, like what is meant by “employee.” The plan drafter cannot assume that the meanings of terms and phrases are self evident. Nevertheless, even the most meticulous drafter cannot anticipate every term that will be brought into question at some undefined future date. Therefore, when such terms do come into question in a benefit appeal, the plan administrator must provide a reasonable, logical and documented basis for his or her decision.