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Pension De-Risking Litigation: Recent Developments

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Recent volatility in capital markets has contributed to the sense that defined benefit plans can represent an unwelcome risk to the balance sheets of employers who sponsor them. Accordingly, plan sponsors are developing approaches to manage—and in some cases eliminate outright—this risk.[1] So called "de-risking strategies" have emerged, consisting broadly of two discrete approaches. In some cases, plan sponsors retain the pension assets (and corresponding ongoing liabilities) but fashion an investment strategy that attempts to mirror the nature of their liabilities, thereby reducing the potential disparity between investment performance and the plan's fixed obligations. Alternatively, some plan sponsors have gone a step further and off-loaded their liabilities to a third party, usually insurance companies, in the form of group annuity contracts. In this arrangement, the plan participants receive their benefits directly from the annuity provider and the plan sponsor can reap the benefit of removing the liability and its corresponding administrative and regulatory burdens from its books.

It is against this changing landscape that on June 24, 2013, a federal district court in Texas granted a motion to dismiss a class action lawsuit alleging that a pension plan sponsor's transfer of $7.5 billion in plan liabilities to an annuity provider violated numerous provisions of the Employee Retirement Income Security Act of 1974, as amended (ERISA). The original complaint, the June order granting dismissal thereof, and plaintiffs' recently-filed amended pleading[2] taken together provide some helpful clues regarding the potential implications of de-risking, quite possibly the "next big thing" in the arena of ERISA class action litigation. This Litigation Update evaluates the various theories for recovery proposed by the plaintiffs in the Texas case and considers how subsequent courts might go about addressing them.

The case, *Lee v. Verizon Communications Inc.*, arose from a contemplated amendment of the Verizon Management Pension Plan (the

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Plan) whereby Verizon would purchase from a well-established insurance company an annuity contract representing $7.5 billion in pension liability and covering approximately 41,000 retirees.[3] In November 2012, the plaintiffs sought unsuccessfully[4] to enjoin the consummation of the deal and shortly thereafter filed the instant class action lawsuit seeking the equitable relief described below and attorneys' fees. Although defendants prevailed on their motion to dismiss, the court granted leave to replead, which plaintiffs did on July 12, 2013. The amended complaint alleges four separate causes of action:

1. That Verizon's Employee Benefits Committee (the "Benefits Committee") violated ERISA Section 102(b) by failing to provide certain required disclosures to participants;

2. That the Benefits Committee and Investment Management Committees breached their fiduciary duties in violation of ERISA Section 404(a);

3. That the annuitization undertaken by Verizon constituted an unlawful interference with a protected right to benefits in violation of ERISA Section 510; and

4. The plan itself was harmed by the annuity transaction in violation of ERISA Section 409.

This Litigation Update will address each of these counts in turn.

The Disclosure Count: ERISA Section 102(b)

As a preliminary matter, it bears noting that the class action is in fact comprised of two separate classes: namely, the Transferee Class (representing those plan participants whose benefit obligations were outsourced) and the Non-Transferee Class (representing those with benefits remaining in the plan). The ERISA Section 102(b) count contends that members of the Transferee Class were injured by the failure of the plan's summary plan description to include information pertaining to the possibility of annuitization and the consequences flowing therefrom.[5] Plaintiffs relied primarily on an interpretation of ERISA Section 102(b) and its applicable regulations to require the SPD to advise participants specifically of "circumstances which may result in … loss … of any benefits that a participant or beneficiary might otherwise reasonably *expect the plan to provide*."[6] While the court, in its memorandum granting the motion to dismiss the original complaint, rejected the contention that pension benefits provided by a third party by way of the original plan should run afoul of this disclosure provision, the amended complaint also alleges that another benefit has been denied participants—namely, protections afforded by ERISA and the Pension Benefit Guaranty

Corporation (PBGC). The amended complaint argues, therefore, that the involuntary ejection from the pension plan and insertion into an annuity contract is itself a loss of a benefit worthy of notice under ERISA Section 102(b).[7]

The Fiduciary Count: ERISA Section 404(a)

The plaintiffs contend that Verizon, through its adoption and implementation of the amendment authorizing the purchase of an annuity contract, breached its fiduciary duties of loyalty and care with respect to the Transferee Class.[8] While the court's memorandum opinion cited ample case law for the proposition that amending a plan is a settlor function not subject to fiduciary obligations,[9] it also allowed for the possibility that the implementation of an amendment could constitute a fiduciary act covered by ERISA Section 404. Elements of the implementation, specifically the selection of the insurance company as the annuity provider and the price paid by Verizon for the contract, could be subject to close scrutiny. While the court held in its dismissal of the original complaint that no sufficient set of facts had been alleged, the plaintiff's amended pleading has supplemented its original theory with allegations that Verizon (i) knew or should have known of the annuity provider's intention to challenge the Department of Treasury's Financial Stability Oversight Council's (FSOC) designation of it as a "systemically important financial institution" (thereby exposing annuitants to additional risk); (ii) that the selection process for an annuity provider was a sham; and (iii) that nothing in the plan amendment itself necessitated removing assets from the plan, i.e., the annuity contract could have remained within the trust.[10]

The Discrimination Count: ERISA Section 510

Section 510 of ERISA makes it unlawful "for any person to discharge, fine, suspend, expel, discipline, or discriminate against a participant or beneficiary…for the purpose of interfering with the attainment of any right to which such participant may become entitled."[11] In the original complaint, this count depended on the supposition that there was a right to continuing participation in the plan—a right that was allegedly abridged inherently by the involuntary transfer of some (but not all) of the plan's participants.[12] In its order dismissing this count, the court rejected continued participation as an "attainable right" under Section 510.[13] To work around this, the amended count substantially overlaps with the underlying theory of the ERISA Section 102(b) argument—namely, that ERISA and PBGC protections and guarantees are themselves rights the attainment of which was interfered with by the annuity purchase transaction.[14]

The Non-Transferee Count: ERISA Section 502(a)(2)

This count alleges that the annuity contract purchase, as well as $1 billion in associated third-party fees paid from the trust, represents a depletion of plan assets in violation of ERISA Section 409.[15] Plaintiffs have alleged and re-alleged that the reduction in plan assets has led to a reduction of diversification and commensurate increase in investment risk. Whether this constitutes a cognizable injury under ERISA will depend largely on the issue of standing, but the Memorandum Order and Opinion issued by the court in June suggests skepticism that ERISA Section 409 might be invoked to give rise to an independent cause of action.[16]

Conclusion

Defined benefit plan sponsors and their counsel, particularly those actively contemplating de-risking, would be well advised to monitor the progress of the *Lee* case and any comparable litigation inspired by it and to adapt their strategies accordingly—lest the risk of runaway pension liability be replaced by the risks of costly litigation.

Notes

1. *See, e.g.*, "MetLife U.S. Pension Risk Behavior Index" (2013).

2. Amended Complaint, Lee v. Verizon Commc'ns Inc., 12-cv-4834, U.S. Dist. N. Tex. (filed Jul. 12, 2013).

3. *Id.* at ¶¶ 1-6.

4. Lee v. Verizon Commc'ns Inc., 2012 WL 6089041 (N.D. Tex. Dec. 7, 2012).

5. Am. Compl. at ¶¶ 37-38.

6. 29 C.F.R. § 2520.102-3(l).

7. Am. Compl. at ¶¶ 25-26.

8. Am. Compl. at ¶¶ 99-105.

9. Mem. Order and Op., at 8.

10. Am. Compl. at ¶¶ 106-108.

11. 29 U.S.C. 1140.

12. Am. Compl. at ¶¶ 120-126.

13. Mem. Order and Op. at 15-16.

14. Am. Compl. at ¶¶ 127-128.

15. Am. Compl. at ¶¶ 133-134.

16. Mem. Order and Op. at 19-20.

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