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Plan Sponsors Can Learn Several Powerful Lessons from *Osberg* Case

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A recent court decision underscores the importance of clear employee communications when describing a change in benefits.

In *Osberg v. Foot Locker Inc.*, 07 Civ. 1358 (KBF) (S.D.N.Y, Oct. 5, 2015), the U.S. District Court for the Southern District of New York found that a plan sponsor did not clearly communicate the concept of "wear-away" — the time after conversion during which an employee does not accrue additional pension benefits — to plan participants when converting its traditional defined benefit plan to a cash balance plan.

Foot Locker argued that describing wear-away would have been too confusing for participants.

The plaintiff argued that the participants would have understood if it had been communicated and that Foot Locker "deliberately obfuscated it."

The court ordered the plan sponsor to give participants the benefits they thought they were going to receive based on their understanding of the employer's communications describing the plan change. In its opinion, the court stated that, "This case presents a more egregious set of circumstances than *Amara,*" a landmark case in which the Supreme Court held that ERISA did not give a federal district court the authority to change the plan's terms because of a deficient summary plan description but it does authorize equitable relief (see September 2011 column on *CIGNA Corp. et al. v. Amara et al.* (No. 09-804)).

We haven't heard the last of this case, as Foot Locker has stated it would appeal.

Background

Foot Locker maintained a traditional defined benefit pension plan with participant benefits based on compensation and years of service. The plan was converted to a cash balance pension plan effective Jan. 1, 1996. Because the interest rate used to value the participants' accrued benefit at conversion was greater than the interest rate used for benefits accruing after conversion, the majority of participants were subject to wear-away. The term was not explained to participants, even though it affected a majority of them.

What Is Wear-away?

During the wear-away period, accrued DB benefits are basically frozen until the cash balance account grows sufficiently to produce a benefit greater than the accrued DB benefit as of a certain date (Dec. 31, 1995, for Foot Locker).

Foot Locker used a 9-percent interest rate to calculate the lump-sum value of a participant's age 65 benefit accrued as of Dec. 31, 1995. The age-65 lump sum was discounted to Jan. 1, 1996, to reflect the time value of money, again using a 9-percent interest rate and further discounting to reflect the possibility of a participant's death before age 65. After conversion, participants' hypothetical account balances were credited with pay credits at a fixed interest rate of 6 percent.

ERISA's anti-cutback rules ensure generally that a participant's accrued benefit cannot be reduced. As a result, the amended plan provided that participants would receive a benefit equal to the greater of the accrued benefit as of Dec. 31, 1995, (referred to as the "A" benefit) or the benefit payable under the amended plan (referred to as the "B" benefit). However, because of the disparate interest rates, participants' hypothetical account balances appeared to grow but in fact were smaller than the Dec. 31, 1995, accrued benefit.

Note: *The Pension Protection Act of 2006 prohibited wear-away for defined benefit plans converting to a cash balance formula on or after June 29, 2005. For such plans, participants must receive the sum of the pre-amendment benefit plus benefits under the new cash*

See *Andersen*, p. 2

Andersen (continued from p. 1)

balance formula, rather than the greater of the benefit at conversion or at time of retirement.

Communicating the Change to Participants

Foot Locker sent an announcement letter on Sept. 15, 1995, to participants announcing a "more competitive retirement benefits package" including a new 401(k) plan. A highlights memo and a revised SPD followed.

The court found that the communications were intentionally false and misleading because they failed to describe wear-away or the reasons for the differences between the accrued benefit at Dec. 31, 1995, and the hypothetical account balance under the new plan.

The court noted that Foot Locker management knew that there would be a temporary freeze on additional benefit accruals and that future accruals would be "lower and slower." Foot Locker testimony revealed a strategy that communications would be limited to good news and not mention that some participants would experience a benefit freeze until the wear-away period was over. In fact, an "overwhelming" number of employees would be negatively affected by wear-away.

Foot Locker admitted that "the very purpose of keeping wear-away a secret was to avoid negative publicity, loss of morale and inability to hire and retain employees." In effect, the plan fiduciaries violated their fiduciary responsibility by putting the interest of the company ahead of the participants.

Note: *Interestingly, in testimony, the Foot Locker vice president of human resources noted that she did not consider herself or Foot Locker to be a fiduciary when drafting participant communications. In addition, Foot Locker parent company Woolworth's CEO denied understanding fiduciary obligations or that he himself was a fiduciary.*

The highlights memo distributed on Nov. 17, 1995, stated that participants would have the option of taking a lump-sum payment equal to their account balance, but this was not the case because the accrued benefit at Dec. 31 of that year was the benefit payable for participants affected by wear-away.

The SPD said that a participant's benefit would be based on the hypothetical account balance, but that was not the case for participants in the wear-away period.

Participants also received personal benefit statements indicating that they could expect to receive their account balance if they didn't accrue any more benefits and elected a lump sum. This too was not true for participants in the wear-away period.

There was no mention of wear-away in the participant communications, despite counsel's advice that such language be added, noting that the Dec. 31, 1995, benefit would be paid if it was greater on an actuarial basis.

Participant testimony showed that they believed they would receive their accrued benefit as of Dec. 31, 1995, and benefits accruing under the amended plan for years beginning as of Jan. 1, 1996.

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The Court's Findings

The court found that Foot Locker violated its fiduciary responsibilities. Participants were not given the truth about their retirement benefits, and the plan fiduciaries demonstrated "fraud or similar inequitable conduct."

As a result, the court ordered that the plan must provide participants with their accrued benefits as of Dec. 31, 1995 (the A benefit), calculated using a 6-percent interest rate (rather than 9 percent), and no mortality adjustment and benefits accrued after the conversion (the B benefit) using a 6-percent interest rate as well as any other onetime enhancements under the plan. In addition, any other regulatory adjustments required at the time of payment as described in the SPD are to be applied to the calculation.

The Court's Analysis

The court found that ERISA Section 502(a)(3) states that a civil action may be brought by a participant to stop ERISA violations or to obtain equitable relief for the violations. The plaintiffs claimed that Foot Locker violated Sections 404(a) and 102(a) of ERISA by issuing materially false and misleading statements in the SPD, various summaries of material modifications, the announcement letter about the plan changes, the highlights memo and the January 1996 Benefits Statement.

The court ruled that to obtain equitable relief, the plaintiff must show:

See *Andersen*, p. 3

Andersen (continued from p. 2)

1. violations of ERISA Sections 404(a) and 102(a) based on the preponderance of evidence;
2. mistakes or ignorance by employees of "the truth about their retirement benefits," based on clear and convincing evidence; and
3. "fraud or similar inequitable conduct" by the plan fiduciaries, based on clear and convincing evidence.

The court found that the plaintiffs demonstrated all of these elements and were entitled to relief.

Fiduciary Responsibility

Fiduciaries must act for the exclusive benefit of plan participants. Citing other case law, the court wrote in its decision: "The most important way in which the fiduciary complies with its duty of care is to provide accurate and complete written explanations of the benefits available to plan participants and beneficiaries." (from *Kenseth v. Dean Health Plan, Inc.,* 610 F.3d 452, 471 (7th Cir. 2010); see also *Bixler v. Central Pa. Teamsters Health & Welfare Fund,* 12 F.3d 1292, 1300 (3d Cir. 1993)).

Be Prepared for 'Litigation Hold'

Generally, when there is a lawsuit, a memo is issued to all interested parties instructing the recipient not to destroy any documentation related to the issue at hand. This is often referred to as a "litigation hold."

Before this particular lawsuit, plaintiff Geoffrey Osberg had filed two previous suits against Foot Locker, the first in 2006. Foot Locker did not issue a litigation hold until 2009. Osberg brought suit for "spoliation," claiming that Foot Locker had destroyed documents that would have been useful to his case. During discovery, it was noted that of the 141 boxes destroyed, some contained files relating to the retirement plan change. The judge concluded that an "adverse inference" instruction was appropriate: When a plaintiff tries to present evidence that would help the case but can't because it has been destroyed, the jury can infer that the evidence would have detrimental to the defendant.

Although the court finding in the class-action lawsuit was based on the evidence presented at trial and did not mention the adverse inference, it is an important point to note for any plan sponsor facing a lawsuit. ❖

Fiduciaries can be held "liable for non-disclosure of information about a current plan when the omitted information was necessary to an employee's intelligent decision about retirement." The court found that Foot Locker "knew and expected that employees would rely on its statements to their detriment."

Citing ERISA Section 102 regulations on what an SPD must contain, the court noted that the "SPD was not written clearly; Participants from a CFO level down failed to understand how their actual benefits would be calculated." The court found that Foot Locker, as plan administrator, violated ERISA Sections 404(a) and 102(a), "providing participants materially false, misleading, and incomplete descriptions of the amended Plan." Foot Locker had a duty to disclose wear-away in a way that the average plan participant could understand.

In the court's opinion, the plaintiffs presented clear and convincing evidence that they were not aware of the "truth about their retirement benefits" and relied on Foot Locker's communications that said their benefits would grow after the conversion.

Citing *Cigna v. Amara,* the court noted that equitable fraud "generally consists of an undue advantage by means of some act or omission which is unconscientious or a violation of good faith." Equitable fraud does not require demonstrating intent but rather a misrepresentation of a material fact. The court found that Foot Locker "[S]ought and obtained cost savings by altering the Participants' Plan, but not disclosing the full extent or impact of those changes."

"Inequitable conduct includes deception or even mere awareness of the other party's mistake combined with the superior knowledge of the subject of that mistake," the *Osberg* opinion continued. Citing other court cases in which inequitable conduct was applied, the court found that the plaintiffs provided "clear and convincing evidence" that Foot Locker engaged in equitable fraud or inequitable conduct regarding the conversion to a cash balance plan.

Statute of Limitations

You may be thinking that if this case originated with an almost-20-year-old amendment, surely the statute of limitations should kick in at some point.

The court determined that an SPD claim is subject to a three-year statute of limitations. A breach-of-fiduciary-duty claim must be brought within six years from the

See *Andersen,* p. 4

Andersen (continued from p. 3)

date of the breach or, if a plaintiff has actual knowledge of the breach, within three years of such knowledge.

There is an exception in the case of fraud or concealment, in which the limitation period runs six years from the participant's discovery of the breach. To have the exception apply, it must be demonstrated that the fiduciary breached its duty by making a knowing misrepresentation or omission of a material fact on which the participant relied to his/her detriment, or the fiduciary engaged in acts that would hinder discovery of the breach.

The court found that the exception applied based on the evidence presented at trial.

What Can Plan Sponsors Learn?

- **Conduct fiduciary training** — It is important that key players in a company's retirement plan understand their roles as fiduciaries and the implications of being one. Periodic training is a must.
- **Communications** — Plan provisions, especially plan changes, must be communicated clearly. There can be no sugar-coating adverse news for participants.
- **Litigation hold** — As soon as you become aware of a lawsuit against the plan, make sure you send a memo to all affected departments advising them not to destroy any documentation that could be related to the case. (See box on p. 3.) ❖

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