DechertOnPoint

July 2008 / Special Alert

A legal update from Dechert's Labor and Employment and Employee Benefits and Executive Compensation Groups

Supreme Court Issues Two Significant Employee Benefits Decisions, But Uncertainty Remains

In its recent decisions in *Kentucky Retirement Systems v. E.E.O.C.* and *Metropolitan Life Insurance Company v. Glenn*, the United States Supreme Court addressed several important issues regarding the design of employee benefit plans and related litigation. Both decisions, however, have unfortunately left a number of significant issues undecided and may lead to confusion and uncertainty for litigants and courts alike.

Kentucky Retirement Systems v. E.E.O.C.: Rejecting the Position of the EEOC, Court Holds that Using Age as a Factor In Determining Disability Pension Does Not Violate ADEA

In *Kentucky Retirement Systems v. EEOC*, the United States Supreme Court considered whether a retirement plan is discriminatory due to the use of age as a factor in determining retirement benefits. In a 5-4 decision, the Court concluded in an opinion by Justice Breyer that the disability retirement plan offered by the State of Kentucky did not discriminate against older workers on the basis of age despite arguably treating younger employees more favorably in certain circumstances in calculating the amount of the benefits due under the plan.

The issue arose from a special retirement plan created by Kentucky for the benefit of its state and county employees holding certain "hazardous positions," such as police officers, firefighters, correctional facility workers, and paramedics. These employees were eligible for normal retirement benefits after working either 20 years or just five years and attaining age 55. The plan's benefit formula was years of service times 2.5% times final annual pay. However, in the event an employee became disabled before being eligible for normal retirement benefits, the plan credited the disabled employee with the number of additional years of service necessary to attain normal retirement benefits. The plaintiff became disabled at age 61 after completing 18 years of service. Because he was eligible for normal retirement benefits at the time of his disability under the normal retirement plan provisions, Kentucky did not add any additional imputed years of service in calculating the plaintiff's benefits. The plaintiff alleged that Kentucky's plan violated the Age Discrimination in Employment Act (ADEA) by providing benefits to younger employees—specifically the imputation of additional years of service needed to bring the employee to normal retirement age—that were denied to older workers, i.e., not giving them additional service credit because they were already eligible for normal retirement.

In rejecting this argument, the Court relied on its earlier decision in *Hazen Paper Co. v. Biggins*, 507 U.S. 604 (1993). In *Hazen*, a case in which a 63-year-old employee with 9 1/2 years of service claimed that his employer terminated his employment in order to avoid paying him pension benefits that he would have been entitled to after 10 years of service, the Court found that in order to establish a violation of the

Dechert LLP

ADEA, a plaintiff must demonstrate that age "actually motivated" the differential treatment to which he or she was subjected by an employer. When not used as a "proxy for age," discrimination based on "pension status" alone does not violate the ADEA. In applying this standard, *Hazen* held that age and pension status are "analytically distinct" concepts.

In *Kentucky Retirement Systems*, a majority of the Court reasoned that Kentucky's plan was not a proxy for age because the plan was offered to all employees in hazardous positions when they were hired and on the same terms. Further, the plan only imputed those years necessary to put a disabled worker in a position as if he had worked a full twenty years or until the retirement age of 55. As such, eligibility for normal retirement, not age, became the determinative factor. The Court noted that the plan did not make assumptions about the work capacity of older versus younger workers and concluded that the "plan [did] not rely on the stereotypical assumptions that the ADEA has sought to eradicate." In his opinion, Justice Breyer noted a number of policy-based arguments, including the argument presented by amicus curiae that a contrary ruling would result in a large increase in pension liabilities, a potential reduction in benefits for all disabled employees, or both. The Court emphasized that its decision was not intended to change the rule that a statute or policy that discriminates based on age violates the ADEA. The Court, however, turned away from the rigid rule-based approach endorsed by the EEOC in its Compliance Manual that any differential treatment of employees of different ages causes a plan to violate the ADEA.

In an odd combination of justices, Justice Kennedy, joined by Justices Scalia, Ginsburg, and Alito, dissented in a lengthy and strongly-worded opinion. The proper interpretation of the ADEA—which provides that an employee benefit plan may not "discriminate against any individual . . . because of such individual's age"—is a straightforward one, Kennedy wrote: "when an employer makes age a factor in an employee benefit plan in a formal, facial, deliberate, and explicit manner, to the detriment of older employees, this is a violation of the [ADEA]." It is inappropriate, the dissent stated, to require that "even when it is evident that a benefits plan discriminates on its face on the basis of age, an ADEA plaintiff still must provide additional evidence that the employer acted with an 'underlying motive'...to treat older workers less favorably than younger workers."

While the Court's decision permits employers more flexibility in the drafting and adopting of pension plans programs that use age as a factor in benefits calculations, employers must be mindful that discriminatory pension plans "actually motivated by age" will run afoul of the ADEA and could lead to disqualification of the plan from favorable tax treatment and substantial monetary damages. Additionally, the opinion reinforces the importance for plan drafters to ensure that there is clearly articulated economic or other non age-based justification for any plan provisions that could potentially adversely impact older plan participants and their beneficiaries.

***Metropolitan Life Insurance Company v. Glenn*: Structural Conflict of Interest a ''Factor'' in Determining Whether a Plan Administrator Has Abused Its Discretion**

In *Metropolitan Life Insurance Company v. Glenn*, the Supreme Court held that an employer or insurer that both funds an employee benefit plan and exercises discretion in deciding claims under the plan "is operating under a conflict of interest [that] must be weighed as a factor in determining whether there is an abuse of discretion" under the Employee Retirement Income Security Act (ERISA). Unfortunately, as observed by Chief Justice Roberts and Justice Scalia in their separate opinions, the Court provided little guidance with respect to the fundamental question of how such a conflict should actually impact a reviewing court's analysis of the employer or insurer's decision.

The case arose out of an application for long-term disability benefits filed by an employee of Sears, Roebuck & Company who had been diagnosed with a heart disorder. Metropolitan Life, which both administered and insured the plan, denied the claim on the basis that she was not prevented by her condition from performing sedentary work. The district court upheld Met Life's decision, but the Sixth Circuit reversed, finding that although the language of the plan entitled Met Life to a deferential standard of review under *Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101 (1989), the district court erred in not considering that Met Life was also operating under a conflict of interest due to its dual role as plan administrator and benefits payor, in making its decision.

The Supreme Court, with Justice Breyer writing for himself and Justices Stevens, Ginsburg, Souter, and Alito, and Chief Justice Roberts concurring in the judgment, affirmed. The Court began by emphasizing that the Sixth Circuit correctly based its analysis on the decision in *Firestone* and the law of trusts. It then concluded that "the fact that a plan administrator both evaluates claims for benefits and pays benefits claims creates the kind of

'conflict of interest'" that the Court in *Firestone* held must be considered by a court reviewing the administrator's denial of benefits. The Court went on to reject Met Life's argument that there is a significant distinction between an employer that both administers a plan and pays benefits under it and an insurance company that plays both roles because an insurance company is subject to market forces that will "punish an insurance company when its products . . . fall below par." ERISA imposes "higher-than-marketplace quality standards on insurers," Justice Breyer wrote, and provides for judicial review of benefits denials that "supplements marketplace and regulatory controls."

Most importantly, the majority declined to hold that the existence of a conflict of interest changes the applicable standard of review, from deferential to *de novo*. Instead, the Court concluded that it is appropriate "to apply a deferential standard of review to the discretionary decision-making of a conflicted trustee, while at the same time requiring the reviewing judge to take account of the conflict when determining whether the trustee . . . has abused his discretion." The Court also declined to create a "special burden of proof rules, or other special procedural or evidentiary rules, focused narrowly upon the evaluator/payor conflict." Rather, the existence of a conflict of interest must just be one of "several different considerations" that a judge must weigh in determining whether there has been an abuse of discretion.

The Court also noted that a structural conflict "should prove less important (perhaps to the vanishing point) where the administrator has taken active steps to reduce potential bias and to promote accuracy, for example, by walling off claims administrators from those interested in firm finances, or by imposing management checks that penalize inaccurate decisionmaking irrespective of whom the inaccuracy benefits." Finding an absence of "efforts [by MetLife] to assure accurate claims assessment," the Court ultimately affirmed the Sixth Circuit's decision reversing the district court's finding in favor of Met Life.

Chief Justice Roberts and Justice Scalia, although they wrote separate opinions and reached different conclusions regarding the ultimate issue of the propriety of the Sixth Circuit's decision,[1] expressed concerns regarding the practical workability of the majority's rule. According to Scalia, the Court's opinion is "painfully opaque" and "unclear" with respect to how its rule should be applied, while the Chief Justice criticized the majority for being "so imprecise about how the existence of a conflict should be treated in a reviewing court's analysis."

Both Scalia and Roberts would have adopted a rule pursuant to which the existence of a conflict is only relevant "where there is evidence that the benefits denial was motivated or affected by the administrator's conflict." This rule is consistent with the law of trusts, they argued, and, since "the lion's share of ERISA plan claims denials are made by administrators that both evaluate and pay claims," is necessary to avoid "near universal review by judges *de novo*."[2]

While the Court did resolve an important issue in its decision, the standard it articulated provides little practical guidance for those litigating ERISA claims. As Chief Justice Roberts and Justice Scalia recognized, despite its lip service to the importance of applying a genuine abuse of discretion standard of review to the decisions of administrators that both pay benefits and decide claims, the Court's decision does in fact seem likely to render largely illusory the deference that should be afforded under *Firestone* to such decisions. In the wake of this decision, therefore, employers must take a hard look at the structure of their plans to ensure that the impact of any structural conflicts that exist are mitigated by the procedural safeguards the majority suggests can be used to render a conflict "less important."

This update was authored by J. Ian Downes (+1 215 994-2346; ian.downes@dechert.com) and Shannon L. Rushing (+1 215 994-2949; shannon.rushing@ dechert.com).

[1] Scalia would have reversed the Sixth Circuit and remanded, while Roberts voted to affirm the judgment "because the court was justified in finding an abuse of discretion on the fact of this case—conflict or not."

[2] Scalia also criticized the majority's decision to "volunteer" that its holding should apply to both conflicted third-party plan administrators and to employers that both pay benefits and decide plan claims. Scalia wrote that "[a]t least one Court of Appeals has thought that while the insurance-company administrator has a conflict, the employer-administrator does not," that he "would not resolve this question until it has been presented and argued, and the Court's unnecessary and uninvited resolution must be regarded as dictum."

Dechert LLP

Practice group contacts

If you have questions regarding the information in this legal update, please contact the Dechert attorney with whom you regularly work, or any of the attorneys listed. Visit us at www.dechert.com/employment or www.dechert.com/employeebenefits.

Richard D. Belford
New York
+1 212 698 3607
richard.belford@dechert.com

Alan D. Berkowitz
Philadelphia
+1 215 994 2170
alan.berkowitz@dechert.com

Susan M. Camillo
Boston
+1 617 728 7125
susan.camillo@dechert.com

Robert A. Cohen
New York
+1 212 698 3501
robert.cohen@dechert.com

Diane Siegel Danoff
Philadelphia
+1 215 994 2179
diane.danoff@dechert.com

Matthew V. DelDuca
Princeton
+1 609 620 3202
matthew.delduca@dechert.com

Vernon L. Francis
Philadelphia
+1 215 994 2577
vernon.francis@dechert.com

Jerome A. Hoffman
Philadelphia
+1 215 994 2578
jerome.hoffman@dechert.com

Nicolle L. Jacoby
New York
+1 212 698 3820
nicolle.jacoby@dechert.com

Thomas K. Johnson II
Philadelphia
+1 215 994 2756
thomas.johnson@dechert.com

David F. Jones
Philadelphia
+1 215 994 2822
david.jones@dechert.com

Paul S. Kimbol
Philadelphia
+1 215 994 2603
paul.kimbol@dechert.com

Stephen W. Skonieczny
New York
+1 212 698 3524
stephen.skonieczny@dechert.com

Claude M. Tusk
New York
+1 212 698 3612
claude.tusk@dechert.com

Kathleen Ziga
Philadelphia
+1 215 994 2674
kathleen.ziga@dechert.com

Dechert LLP

www.dechert.com

© 2008 Dechert LLP. All rights reserved. Materials have been abridged from laws, court decisions, and administrative rulings and should not be considered as legal opinions on specific facts or as a substitute for legal counsel. This publication, provided by Dechert LLP as a general informational service, may be considered attorney advertising in some jurisdictions. Prior results do not guarantee a similar outcome.

U.S. Austin • Boston • Charlotte • Hartford • Newport Beach • New York • Philadelphia Princeton • San Francisco • Silicon Valley • Washington, D.C. • **EUROPE** Brussels London • Luxembourg • Munich • Paris • **ASIA** Hong Kong