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RESEARCH MEMO

Sixth Circuit Court Case on Cutbacks to Post-Retirement Benefit Increases Generates Interest

A recent decision by the Sixth Circuit Court of Appeals generated several calls and comments to the Research Department. On appeal to the Sixth Circuit, a Plaintiff-retiree alleged: (1) his Pension Fund violated the *ERISA* anti-cutback rule by rescinding an increase of retirement benefits, which was introduced after he had retired; and (2) the Board violated its fiduciary duty under *ERISA* by passing the amendment, which rescinded the increase.

The Sixth Circuit affirmed the district court ruling that a benefit increase that was given after a participant's severance from employment was not an "accrued benefit" within the meaning of *ERISA's* anti-cutback rule; therefore, the Trustees did not violate their fiduciary duties. The inquiries we received regarding the decision were from Plans that are in critical or endangered status who wondered if this case meant they could safely cut post-retirement benefit increases.

The case is *Thornton v. Graphic Communications Conference of Intern. Broth. of Teamsters Supplemental Retirement and Disability Fund,* 566 F.3d 597 (6th Cir. 2009). A copy of the case is available by "*clicking here*." The underlying district court opinion is available by "*clicking here*."

It is important to note that the IRS published a Regulation in 2005 (*26 C.F.R. § 1.411(d)-3*, 70 Fed. Reg. 47109), after the initiation of the lawsuit, that specifically says post-retirement benefit increases CANNOT be cut without violating the anti-cutback rule, stating in relevant part:

> The protection of Section 411(d)(6) [anti-cutback rule] applies to a participant's entire accrued benefit under the plan as of the applicable amendment date, without regard to whether the entire accrued benefit was accrued *before a participant's severance from employment* **or** whether any portion *was the result of an increase* in the accrued benefit of the participant pursuant to a plan amendment *adopted after the participant's severance from employment*.

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Thus, any Board of Trustees that wishes to rely on the *Thornton* decision to support cuts in post-retirement benefit increases should be aware that this 2005 IRS regulation which would be applicable to any such cutbacks is directly contrary to *Thornton*.

However, it cannot be said that the courts would automatically give deference to the IRS regulation since it is a post-hoc interpretation not issued contemporaneously with the original regulation on the subject. The *Thornton* opinion and the cases it relied on were based on statutory interpretation of the legislative history and plain meaning of the words of the applicable sections of *ERISA* and the Code. Whether a post-hoc change in interpretation of the concept post-retirement benefit increases by the IRS would trump prior interpretations of the statutes by the Circuit courts will need to be "duked out" in the courts.

The *Thornton* case contains a lengthy discussion of the concept of court's deference to agency regulations and is an instructive refresher on the matter. According to *Thornton*, the 2005 regulation appears to be a change in the IRS' position, which may impact the amount of deference, if any, given the regulation by courts in future litigation. Plans considering cutting post-retirement benefit increases may find it useful to have Fund Counsel research other instances where an agency has issued a regulation similar in effect to the 2005 regulation and how the courts dealt with such regulations. At the very least, a review of the *Preamble* to the 2005 regulation may be a useful starting point.

FACTS AND TIMELINE OF THE CASE

The Pension Plan

The Pension Plan, the Graphic Communications Conference of the International Brotherhood of Teamsters Supplemental Retirement and Disability Fund, was a multiemployer benefits plan that provided retirement benefits to employees in the graphic communications industry. The Plaintiff worked under covered employment until he retired on February 1, 1995 and commenced receiving his retirement benefits under the terms of the Pension Plan.

The Post-Retirement Benefit Increases

Less than two years after the Plaintiff's retirement, the Trustees amended the Plan to provide a 3% increase in benefits for all active and retired participants effective February 1, 1997. The Trustees again amended the Plan the following year to provide an additional 4% benefit increase, compounded, to all participants effective February 1, 1998. In January of 1999, the Trustees amended the Plan for a third time, and increased all participants' benefits by an additional 9.4%, compounded, effective February 1, 1999.

The Trustees Rescind the 9.4% Benefit Increase

In December 2002, the Trustees adopted a benefits reduction proposal, effective April 1, 2003, to rescind the third benefit increase (the 9.4% increase) for Plan

participants, like the Plaintiff, who retired from covered employment prior to February 1, 1999. The prior two benefit increases were left intact. The Trustees alleged the amendment to rescind the 9.4% increase was passed in response to advice received from an actuarial consultant who claimed the Plan faced a significant funding shortfall, which, if not remedied, would jeopardize the Plan's long term financial viability.

The Plaintiff Files Suit

As is often the case when "one's ox is being gored", the Plaintiff sought relief at court and filed a class action suit against the Pension Fund on behalf of himself and other similarly situated individuals who received Plan benefits prior to February 1, 1999 and experienced a reduction in those benefits as a result of the December 2002 Amendment rescinding the 9.4% increase.

In the district court, the Plaintiff's Complaint alleged that by rescinding the benefit increase provided to those employees who had retired prior to February 1, 1999, the Plan and the Board of Trustees violated the anti-cutback rule set forth in *ERISA* Section 204(g). The Plaintiff also alleged the Board of Trustees, in taking such action, breached their fiduciary duty by failing to administer the Plan in accordance with *ERISA* Section 404(a)(1)(D).

The district court ruled that the December 2002 Amendment rescinding the 9.4% increase did not violate the *ERISA* anti-cutback rule because the Plan amendment granting the increase was adopted **after** Thornton retired in 1995. Having held that the rescission of the 9.4% increase was not in violation of *ERISA,* the court reasoned that the Trustees similarly did not breach its fiduciary duty in passing the amendment. The district court granted the Defendants' motion for summary judgment and dismissed the plaintiff's complaint. The Plaintiff appealed to the Sixth Circuit.

The Plaintiff Files An Appeal to the Sixth Circuit

The Plaintiff argued on appeal that the Defendants violated *ERISA's* anti-cutback rule by adopting an amendment to the Plan that eliminated the 9.4% benefit increase for pre-February 1, 1999 retirees. The Court noted that the anti-cutback rule (*ERISA Section* 204(g)) prohibits pension plan amendments that decrease plan participants' "accrued benefits." The anti-cutback rule also appears in the Internal Revenue Code (I.R.C. Section 411(d)(6)), pursuant to Title II of the *ERISA* statute, in materially identical form and disqualifies from tax-exempt status those pension plans that violate its conditions.

The Sixth Circuit stated "…*the fundamental question on appeal is whether the Plan's 9.4% benefits increase constituted an "accrued benefit" for pre-February 1, 1999 retiree plan participants such that its later rescission by the December 2002 Amendment violated the anti-cutback rule of IRC Section 411(d)(6)(A).* "

The Sixth Circuit held the 9.4% increase was NOT an "accrued benefit" and rescinding it did not violate the anti-cutback rule.

THE SIXTH CIRCUIT COURT'S REASONING

Treasury Regulations

In reaching its conclusion, the Sixth Circuit undertook a solid analysis of to what extent it must consider, and possibly defer to. In analyzing possible relevant Treasury interpretations of the statutory definition of "accrued benefit" and the corresponding anti-cutback rule, the Court took an in-depth look at the rules governing a courts' deference to the enforcing agency's regulations, as set out in *Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc.,* 467 U.S. 837, 104 S. Ct. 2778 (1984). Further, since the matter was one of "first impression" in the Sixth Circuit, the Court also considered the opinions of other Circuit Courts on the issue.

The Court's analysis of Treasury regulation is lengthy and complex at times and not discussed herein other than to say that the Court found "*no agency regulation-nor even an agency interpretation of its regulations that merits deference-addresses whether [Plaintiff's] post-retirement benefit increase is an accrued benefit",* the 2005 regulation mentioned earlier being inapplicable on its face to the time frames relevant to the Plaintiff's complaint. The Court's comments on the 2005 regulation may be helpful in any future litigation that may arise on this issue.

Cases from Other Jurisdictions

Since the meaning of the "accrued benefit" statutory definition with respect to post-retirement increases in benefits was an issue of first impression in the Sixth Circuit, the Court considered it worthwhile to first examine a Fourth Circuit case which addressed this very issue - *Board of Trustees of Sheet Metal Workers' Nat'l Pension Fund v. Comm'r ("Sheet Metal Workers' "),* 318 F.3d 599 (4th Cir.2003). The Sixth Circuit also cited *Williams v. Rohm & Haas Pension Plan,* 497 F.3d 710, 713-14 (7th Cir.2007).

In the *Sheet Metal Workers'* case, the Fourth Circuit held a 2% annual cost-of-living-adjustment (COLA) granted by the Sheet Metal Workers' National Pension Fund plan to pension fund participants in 1992, effective retroactively to January 1, 1991 and which was later eliminated for participants who retired before January 1, 1991, did not violate the anti-cutback rule.

In reviewing the case on appeal, the Fourth Circuit engaged in a close reading of the text of IRC Section 411(a)(7)(A)(i) and concluded:

> "….the benefit could not have been an "accrued benefit" because it did not accumulate during their service so as to become part of their legitimate expectations at retirement under the terms of the Plan then in effect." (emphasis added)

Rather than considering the COLA an "accrued benefit," the Fourth Circuit Court instead characterized it as a mere "*gratuitous benefit*" provided after retirement which could therefore be withdrawn without impairing the promised benefit that had accrued at retirement."

The Sixth Circuit Court agreed that the Fourth Circuit's thorough analysis of the text and context of IRC Section 411(a)(7)(A)(i) demonstrates that "*Congress did not consider a post-retirement increase in pension benefits to be an "accrued benefit*."

The Sixth Circuit Court concluded it did not find any indication in the language of Section 411(a)(7)(A)(i), or statutory construction thereof, that even remotely suggests that a given participant may amass "accrued benefits" after he or she permanently separates from covered employment.

Consequently, the Sixth Circuit held that a post-retirement increase in benefits does not create an "accrued benefit" for a given participant under IRC Section 411(a)(7)(A)(i) unless it is "in accordance with the plan in effect while the employee works in the service of the employer" and the Plan's rescission of the 9.4% benefits increase for pre-February 1, 1999 retirees in December 2002 did not violate the anti-cutback rule.

The Sixth Circuit also made this interesting observation:

> We also find it significant that [Plaintiff's] proposed construction of "accrued benefit" may cause pension plans to "avoid providing gratuitous benefits in the future for fear of being locked in perpetually." This harmful disincentive would jeopardize the welfare of the very retirees [Plaintiff] seeks to champion through his suit.

The current funding problems facing many multiemployer defined benefit pension plans may force some Pension Plans to cut post-retirement benefits and, undoubtedly, litigation will ensue. The "wild card" will be the 2005 IRS regulations that say post-retirement benefit increases are protected, contrary to the holding of *Thornton.*

Given the pace of litigation, even if a case were filed today against a Pension Plan's post-retirement benefit increase cut, it would probably be six months to a year before a district court decision is reached. For example, the *Thornton* case was originally filed in District Court on March 5, 2007, decided in favor of the Plan ten months later on February 18, 2008 and then decided on appeal in the Sixth Circuit fifteen months later on May 14, 2009.

One should also remember that the Plaintiff in *Thornton* has until about mid-August to file a petition requesting the U.S. Supreme Court to hear an appeal in the case.

The Research Department will keep an eye out for similar litigation and report on pivotal cases.

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