Benefits Brief

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Pepsi Avoids Retirees' Claims Challenging Benefit Conversion Factors

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AUTHORS: Mark Carolan, Katie Kohn, David Levine, Mark Lofgren

Actuarial Equivalence Lawsuits

We previously wrote about the "actuarial equivalence" lawsuits filed by two plaintiffs' firms beginning late last year. These lawsuits—which now number nine—against defined benefit plan sponsors and fiduciaries challenge the mortality assumptions or conversion factors used by plans to calculate non-single-life annuity forms of benefits (*e.g.*, joint-and-survivor, preretirement survivor, or certain-and-life annuities). Defendants in each lawsuit have filed motions to dismiss, and three courts have issued decisions. The first two courts in *U.S. Bancorp* and *American Airlines*, respectively, denied defendants' motions to dismiss, generally holding that discovery is needed to determine whether the plan's assumptions satisfy ERISA's requirements of actuarial equivalence and nonforfeitability. However, the court in *DuBuske v. PepsiCo* handed the defendants a victory in granting the defendants' motion to dismiss, holding that ERISA's nonforfeitability requirement applies only to benefits accrued at normal retirement age, and the plaintiffs did not allege they retired at normal retirement age.

The decision gives some hope for defendants with pending motions to dismiss, but offers only limited help because it does not address a number of defendants' arguments in these lawsuits. And, the court did join the *U.S. Bancorp* and *American Airlines* courts in holding that the plaintiffs' claims were properly alleged under applicable provisions of ERISA.

Actuarial Equivalence Factors and Lawsuits Generally

The Internal Revenue Code ("Code") requires that the assumptions used to convert a participant's benefit from a single-life annuity (the default form of benefit under ERISA) to an optional form of benefit be identified in the plan. ERISA section 205 requires that certain optional forms of benefits be actuarially equivalent to the single-life annuity. ERISA section 203 further requires that an employee's

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right to his “normal retirement benefit” be “nonforfeitable” when he reaches normal retirement age (generally, age 65).

The plaintiffs in these lawsuits challenge the mortality assumptions used by the plans—which, when known, range from the 1951 to 1984 mortality tables. Plaintiffs allege that these tables are outdated, inherently unreasonable, and produce optional forms of benefits that are not as valuable as the single-life annuity. The plaintiffs make their point by comparing their benefits calculated using more current interest rates and mortality tables with their benefits calculated using the plan’s assumptions to show that the former is greater than the latter. Generally, the difference between these benefits is in the single digits as a percentage.

The plaintiffs argue that the lower benefits calculated using plan assumptions violate ERISA’s nonforfeitability and actuarial equivalence requirements under sections 203 and 205, respectively. According to the plaintiffs, these requirements can only be met if a plan uses “reasonable” actuarial assumptions, such as the current assumptions mandated by the Code to be used to calculate lump sum benefits. Because ERISA does not contain this “reasonableness” requirement promoted by the plaintiffs, the plaintiffs rely on the Treasury regulations to support their argument.

PepsiCo Decision

In *PepsiCo*, the plaintiffs each receive joint-and-survivor annuities, which were calculated pursuant to the plan’s conversion factor (the specific mortality table is unknown). The plaintiffs made no allegation that they retired at or after normal retirement age of 65. The plaintiffs alleged that “by not providing an actuarially equivalent benefit, Defendants have violated ERISA’s anti-forfeiture clause. . . .”

In moving to dismiss, the defendants made several arguments. *First*, Pepsi argued that ERISA section 502 does not give the plaintiffs standing to enforce the Treasury regulations cited by the plaintiffs, and that there is no private right of action to otherwise enforce the Treasury regulations. *Second*, the defendants argued that ERISA does not require plans to use “reasonable” actuarial factors when converting a single-life annuity to an optional form of benefit. *Third*, the defendants argued that the difference in the plaintiffs’ benefits calculated under the plan’s terms versus their benefits calculated using the assumptions proposed by the plaintiffs establishes that the plan’s assumptions are reasonable as a matter of law. This is because the difference between the plan benefits and the benefits calculated using more current assumptions is less than three percent, and the Treasury regulations treat as “approximately equal” benefits that are + or – 5 percent of one another. *Finally*, with respect to the fiduciary breach claim, Pepsi argued that the claim fails because the plan terms do not violate ERISA.

On September 25, 2019, the court granted Pepsi’s motion to dismiss. In the nine page ruling, the court made three holdings. *First*, the court held that the plaintiffs’ claims arise under ERISA, not under the Treasury regulations, as the defendants argued. The court acknowledged that the plaintiffs cited the Treasury regulations interpreting the sections of ERISA that form the bases of the plaintiffs’ claims.

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Second, the court held that ERISA's anti-forfeiture clause protects only normal retirement benefits that have accrued upon the attainment of normal retirement age; in other words, "nonforfeitability attaches only *after* the employee attains normal retirement age." And the complaint did not allege that any of the plaintiffs reached normal retirement age when they retired, or that they were deprived of their accrued benefits at normal retirement age. Thus, the court held that plaintiffs' claims that the plan assumptions violate ERISA's non-forfeiture provision were inadequately pled.

Third, the court held that the plaintiffs' fiduciary breach claim failed because the plaintiffs did not adequately plead that the plan's assumptions violate ERISA's non-forfeiture requirement.

GROOM INSIGHT | As mentioned above, the court's dismissal of the claims against Pepsi is a promising development in the line of actuarial equivalence cases, especially after courts denied two motions to dismiss in other cases. To the extent other complaints also fail to allege the plaintiffs were deprived of normal retirement benefits at normal retirement age, this decision could be persuasive.

However, the law still remains unsettled, and the PepsiCo decision does not address all of the arguments raised in these lawsuits. For example, the court did not address plaintiffs' argument that the plan's terms violate ERISA's actuarial equivalence requirement. The court also did not address the arguments that ERISA does not contain a reasonableness requirement at all, or that the plan's assumptions are reasonable because the plaintiffs' benefits are less than five percent lower than the benefits calculated using more current assumptions.

Finally, this court joined the U.S. Bancorp and American Airlines courts in holding that the plaintiffs' claims arise under ERISA, not the Code or Treasury regulations, but that the Code and regulations provide guidance as to ERISA's requirements. These courts' holdings reject the defendants' arguments that the plaintiffs' lack standing to enforce the Treasury regulations or that the plaintiffs' claims fail because ERISA section 502 does not provide plaintiffs with a cause of action to enforce the Treasury regulations.

We anticipate the plaintiffs will appeal the court's decision. Groom will continue to follow these cases and analyze the implications of any future decisions. If you would like to discuss these cases or your plan's actuarial equivalence factors, please contact the authors or your Groom attorney.

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