ERISA Litigation Update

Opening Up the Courthouse Door: The Second Circuit Weighs in on Exhaustion of Administrative Remedies

As I look back on much that I have written about ERISA litigation over the years, both here and elsewhere, several themes emerge. One of the most consistent has been the importance of what I called in a recent article for this journal, operational competence. ["Looking Closely at Operational Competence: ERISA Litigation Moves Away from Doctrine and Towards a Careful Review of Plan Performance," Journal of Pension Benefits *Vol. 20, No. 2 (Winter 2013)] As we move more and more into a world in which employees—who are the plan participants that ERISA is concerned with—are the ones responsible for their retirements, and in many instances for much of the cost and even management of their health benefits, the competency of plan operations becomes more and more central to our, as well as courts', thinking about ERISA plans, responsibilities, and liabilities. This is becoming an explicit and literal concern, as I discussed in my recent article on operational compliance, with legal doctrines governing ERISA litigation moving towards a framework in which problems with competence can more readily be remedied through the court system.*

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It is also, however, present as an underlying, possibly unarticulated idée fix in the evolving context and culture that surrounds ERISA plans. From all directions, the various players in the ERISA universe—courts, regulators, the class action lawyers who play the role of private attorney generals in this area of the law, and lawyers who represent and counsel plans and their sponsors—seem to be converging on the need to fine tune competency in plan operations. The Department of Labor (DOL) is more and more reporting significant recoveries and enforcement actions related to mistakes in operating plans, and in particular with regard to decision making that may not have placed the needs and interests of participants above all else. This is perfectly illustrated by the Employee Benefit Security Administration's recent $80 million settlement with Sherwin Williams over employee stock transactions that appear to have been driven by tax benefits to the sponsor, rather than by a benefit of those transactions to plan participants. Similarly, the Department's effort to expand the range of actors in the ERISA universe who can be declared plan fiduciaries can likewise be understood as an effort to impose more discipline on more actors involved with plans, by placing them in the crosshairs of fiduciary liabilities if they fall below a certain level of competence. Class action cases like *Tussey v. ABB* have made previously accepted practices by vendors, such as profiting from float income, hazardous, and an increase in suits making such claims—such as the recent filings of putative class actions making allegations of fiduciary breaches related to float income—is likely to impose a business cost in the long run (whether just in reputation and legal bills, or possibly in liability payments as well) on ERISA service providers who don't operate at the highest possible levels of professionalism. At the same time, lawyers for plan sponsors are, without doubt, pressing their clients more and more to examine their handling of plan issues so as to avoid the risks that current rulings are putting on them, rather than recommending a more laissez faire approach to plan governance and operation; to confirm this, one need only look at the numerous client advisories and articles that were issued immediately on the heels of the trial court decision in *Tibble v. Edison,* promptly recommending that plan sponsors look carefully at any retail share class holdings in their plans. ["Retreat from the High Water Mark: Breach of Fiduciary Duty Claims Involving Excessive Fees after Tibble v. Edison International," *Journal of Pension Benefits*, Vol. 18, No. 3 (Spring 2011)]

The world, in a nutshell, is tightening up the operations of ERISA plans, and raising the bar as to what is acceptable and unacceptable performance. We just saw another instance of this in early 2013, when the U.S. Court of Appeals for the Second Circuit issued a significant decision holding that plan participants did not have to exhaust their administrative remedies before filing suit against a plan. In *Kirkendall v. Halliburton* [707 F.3d 173 (2d Cir. 2013)], a group of plan participants became convinced that a plan had been revised in a manner that would reduce their pension benefits in the future, when they finally reached retirement age. One of the participants, the named plaintiff Kirkendall, called and wrote the plan sponsor seeking details about the change and information as to her eventual benefit amount upon retirement. Dissatisfied with the response, she, along with other putative class plaintiffs, filed suit. At the district court level, the suit was dismissed, including because Kirkendall had not followed the claim process outlined in the plan documents and, therefore, had failed to exhaust the administrative remedies available under the plan.

Traditionally, until quite recently, the requirement that plan participants exhaust all opportunities provided by a plan for review of a claim before filing suit was strictly applied, with courts barring the courthouse door to participants who failed to do so. Although courts developed several exceptions to the rule, the exceptions were exactly that: exceptions, and ones that were tightly circumscribed by the courts. As a general rule, participants had to put forth a compelling factual case establishing that they actually satisfied the precise requirements of any given exception to be able to avoid having their cases dismissed for failure to exhaust the administrative remedies offered by a plan.

A perfect example of this phenomenon could be seen in the courts' treatment of futility, which is a widely accepted exception to the requirement that a participant exhaust administrative remedies before bringing suit. Under the futility doctrine, internal administrative appeals are not required when pursuing further appeals to the plan administrator would be futile. [*See, e.g., Freeman v. MetLife Group, Inc.*, 583 F. Supp. 2d 218 (D. Ma. 2008).] The futility doctrine, as a general rule, applied, and the exception was satisfied, if the participant could show that the plan sponsor or administrator's past behavior and articulated positions proved that administrative review under the plan would not have resulted in an award of benefits. [*See, e.g., DePina v. General Dynamics Corp.*, 674 F. Supp. 46 (D. Ma. 1987).]

However, courts were generally not kind to claims of futility in this context, as a general rule. In fact, courts were so often averse to such claims that I long ago both channeled and paraphrased Samuel Johnson, arguing that futility is the last refuge of a participant who is just plain out of luck. Much of this history and sense of the doctrine's lack of efficacy stems from extensive misuse of the futility exception by lawyers for participants over the years, who often threw the doctrine out there in pleadings in desperation, without bothering to support the claim with significant evidence. For example, in *Drinkwater v. Metropolitan Life* [846 F.2d 821, 826 (1st Cir. 1988)], the assertion of futility was rejected because a "blanket assertion, unsupported by any facts, is insufficient to call this exception into play." The plan participant in that case provided no evidence in support of the claim of futility. Likewise, in *Curran v. FedEx Ground Package Systems* [593 F. Supp. 2d 341, 346 (D. Ma. 2009)], the futility exception was not applied because the plaintiff had not pled facts showing that the factual prerequisites were satisfied.

With its ruling in *Kirkendall*, however, the Second Circuit released itself from the shackles of decades of case law stringently enforcing the requirement of administrative exhaustion and which only grudgingly allowed participants to proceed with litigation if they had failed to exhaust their administrative remedies. The Court did so by focusing on, consistent with the focus of my recent articles, what I would call the level of operational competence reflected in the plan documents, which the Court found were ambiguous at best with regard to whether a plan participant had to exhaust the plan's administrative remedies before prosecuting the type of dispute over future benefits raised by the plaintiff. The Court found that, although the plan's lawyers claimed in the litigation that the plan documents required the participant to pursue internal administrative appeals, the plan documents did not clearly impose such an obligation. In fact, the Court found the plan documents unclear on this point, and stated that "we imagine that if the plan terms are a bit baffling to us, they are equally baffling to plan participants." With that, and on that basis, the Court let the participant off the hook with regard to exhausting plan remedies before filing suit.

It is true that this is not an unprecedented conclusion. As the Second Circuit itself noted in *Kirkendall*, two other "circuits have held that, where a plaintiff reasonably interprets the plan terms not to require exhaustion and, as a result, does not exhaust her administrative remedies, the case may proceed in federal court." In addition, there have been a smattering of decisions over the years to the same effect, finding that an administrator cannot insist on particular internal claim procedures if the plan documents themselves do not clearly impose them. For instance, as far back as 1997, a federal district court in Vermont had held that a "claimant need only make a written or oral communication reasonably calculated to bring the claim to the attention of a party who handles employee benefit matters, or any officer of the employer" where no formal procedure for filing claims existed under the plan. [*Brace v. IBM*, 953 F. Supp. 561 (D. Vt. 1997)]

Nonetheless, the Court clearly centered its analysis and decision in *Kirkendall* on the wording chosen by the plan's lawyers, and on the failure of that language to clearly require the participant to pursue an internal administrative appeal before filing suit. Properly drawn plan documents, which clearly imposed such an obligation, would have been sufficient to preclude the Court's ruling, and to allow the plan to prevail solely on the ground that the participant had failed to exhaust administrative remedies available under the plan. At the end of the day, a lapse in operational competence cost the plan and its administrator this defense, requiring them to incur the expense of years of litigation.

All was not lost for the plan and its administrator. Ironically enough, they eventually prevailed in the case by displaying significant operational competence when it came to the substance of the plan's terms and the operational realities of changing the plan's benefits. The Second Circuit, after finding that the participant could not be barred from prosecuting a claim because of a failure to exhaust administrative remedies available under the plan, held that the plan participant could not recover because the plan sponsor complied with the necessary formalities for altering future benefits under the circumstances presented to the Court. In the end, what a lapse in operational competence took away, an exercise of it gave back. ■