

## A Summary of Judge Sotomayor's ERISA Decisions

By Mike Vanic and Joe Faucher

President Barack Obama has nominated Judge Sonia Maria Sotomayor to replace retiring Justice David Souter on the United States Supreme Court. As the co-chairs of our firm's ERISA Litigation Department, we monitor the developments in ERISA litigation on a near constant basis. Naturally, we are very interested in how Judge Sotomayor will approach the ERISA cases that will inevitably come before her if her appointment to the Supreme Court is confirmed by the Senate. With the Senate Judiciary Committee's July 28 vote to send the nomination of Judge Sotomayor to the full Senate and the full Senate's vote expected in early August, we thought a brief review of her decisions in cases involving ERISA issues would be timely.

If confirmed, Judge Sotomayor would be the first Hispanic justice and its third female justice. She was initially appointed to the United States District Court by President George H.W. Bush and then elevated to the Court of Appeals by President Bill Clinton. It has often been said by her proponents that Judge Sotomayor would bring more federal judicial experience to the Supreme Court than any justice in 100 years since she served as a United States District judge in the Southern District of New York for over six years and then as a judge of the United States Court of Appeals for the Second Circuit for nearly 11 years. In her time on the Court of Appeals, she has participated in over 3,000 panel decisions and authored approximately 380 opinions. As one might expect, she has had a broad range of experience with ERISA related cases from her tenure as both a district court and court of appeals judge.

### Overview

As a general proposition, there is nothing talismanic in Judge Sotomayor's ERISA decisions. They tend to follow existing law, rather than create it. Her opinions are clear, intelligent and thoughtful. They tend to reflect a thorough research of precedent, a comprehensive study of the record and a methodical examination and analysis of the arguments of the parties. She tends to write narrowly formed opinions, reliant on statute, regulation or existing case precedent rather than based on broad philosophical viewpoints or vague philosophic notions of intent or purpose. Her opinions can be lengthy and demonstrate an attention to detail. She usually discusses the factual record thoroughly and systematically examines every significant legal issue to the point of sometimes raising nuances that the parties themselves have overlooked. There is no pattern in her

decisions to suggest that she is pro-business or anti-business, pro-participant or anti-participant. She appears to rule on cases based on the facts presented and the law to be applied, without any evident emotionalism. If compelled to categorize her ERISA opinions broadly, we would suggest that, for the most part, they represent centrist and mainstream points of view on the issues she has adjudicated.

While on the Second Circuit Court of Appeals, Judge Sotomayor was a member of the panel deciding approximately twenty ERISA related cases. We will briefly discuss the five cases in which she has written the opinion for the Court. In a companion bulletin to be distributed later, we will then discuss a handful of her decisions as a District Court Judge.

### Court of Appeal Decisions Written By Judge Sotomayor

*Strom v. Siegel Fenchel & Peddy P.C. Profit Sharing Plan*, 497 F.3d 234 (2nd Cir. 2007), is Judge Sotomayor's most recent published ERISA decision. The primary issue in *Strom* was the application of the proper standard of review by the court of a decision by the Plan Administrator of a law firm's pension and profit sharing plans. A secondary issue was the impact of the failure by the Plan Administrator to provide the required notice of the basis for rejection of the participant's claim. With regard to the primary issue, Judge Sotomayor held that while the Plan contained the requisite grant of discretion to the Plan Administrator with regard to claims determination and Plan interpretation, the district court erred in applying the abuse of discretion standard of review because the Plan Administrator in fact had not exercised its discretion in deciding the issue and therefore there was no decision by the Plan Administrator to which the court could defer. Therefore, the court had to review the issue *de novo*. Concerning the secondary issue, Judge Sotomayor held that where the Plan Administrator failed to satisfy the notice requirements of ERISA §503(1) and (2) and DOL Reg. 2560.503-1(g)(1), as a matter of law, the Plan could not establish a waiver of the participant's right to administrative review.

*Strom* concerned a claim by a former "partner" of an incorporated law firm for a declaration of her rights under the firm's Cash Plan and Profit Sharing Plan and a claim for breach of fiduciary duty against the Plans' Administrators. *Strom* claimed that because she was a partner in the firm she was among the subset

of employees who received an “increased contribution” under the Plans. On motion for summary judgment, the district court concluded that under the arbitrary and capricious (*i.e.*, abuse of discretion) standard of review, it was required to defer to the Plan Administrator’s determination and that, accordingly, Strom’s claim that she was a partner and therefore entitled to an increased contribution was foreclosed by the administrative decision with regard to the PS Plan. As to the Cash Plan, the district court concluded that Strom had waived her claim by failing to exhaust her administrative remedies.

Judge Sotomayor vacated the judgment of the district court and remanded. She found that the record established that the Plan Administrator had not, in fact, ever issued a final decision on its review of Strom’s profit sharing claim, and therefore the claim was “deemed” denied. As such, Judge Sotomayor concluded “the Plan administrators explicitly refused to decide Strom’s claim, and such a non-decision cannot be deemed an ‘exercise of discretion’ to which the district court might have deferred,” adding: “[b]ecause a non-existent interpretation cannot be a reasonable one, the district court erred in deferring to the Profit Plan administrators’ Decision.” Thus, Judge Sotomayor remanded, instructing the district court to apply the *de novo* standard of review.

With regard to the Cash Plan claim, the record indicated that the Plan administrator rejected Strom’s claims, summarily explaining by letters that she was not eligible to receive Plan documents or benefits, “[a]s she was not a partner or shareholder.” The Plan administrators conceded the letters failed to satisfy the notice requirements of ERISA §503(1) and (2) and DOL Reg. 2560.503-1(g)(1). Judge Sotomayor concluded that the district court’s ruling that Strom waived her claim by failing to exhaust her administrative remedies was therefore untenable, holding: “In a case such as this one, where the plan administrator has denied a claimant’s very status as a plan participant and consequently refused to produce plan related documents – which the claimant had specifically and repeatedly requested – we hold that, as a matter of law, the plan cannot make the requisite showing concerning the knowing or voluntary nature of the claimant’s alleged waiver of his or her rights to administrative review.” Consequently, the judgment on the Cash Plan was also vacated and remanded for further proceedings consistent with the decision.

The decision in *Strom* demonstrates a clear understanding of the legal precedents regarding the standard of review to be applied in reviewing plan administrator decisions and the administrative claims requirements of ERISA, and attention to subtle distinctions. It breaks no new grounds, but it does show the appropriate application of the facts to the law in question.

*Supplee v. Bethlehem Steel Corp. (In re Bethlehem Steel Corp.)*, 479 F.3d 167 (2nd Cir. 2007), involved a claim by a former employee in the Bethlehem Steel Chapter 11 bankruptcy proceeding to have a portion of his pension benefit claim treated as severance pay and thus be entitled to priority payment as an administrative expense. It is an interesting case involving the intersection of bankruptcy law and ERISA principles. After a thorough analysis of the parties’ arguments, Judge Sotomayor affirmed the decisions of the bankruptcy court and the district court and held that no part of the

amount of the lump sum payment of the participant’s benefit was a new benefit earned at termination. Rather, the entire payment represented the accelerated payment of benefits that the employee earned in the course of his employment, and therefore, no part of the payment was entitled to administrative expense priority.

The Plans in question, two SERPs, were adopted by Supplee’s original employer, Lukens, Inc. Each had a provision that provided that if an employee retired before age 62, there was an early retirement penalty of four percent of the total accrued benefits for each full year by which the employee was younger than 62. However, each SERP also had a change-in-control provision allowing a participant to receive a full lump sum benefit before 62 with no early retirement penalty where, for example, within 5 years of the change-in-control the employee was terminated other than for cause. Bethlehem Steel Corporation (“BSC”) acquired Lukens. Three years later it filed for relief under Chapter 11. As part of BSC’s reorganization, Supplee’s employment was terminated in connection with BSC’s sale of substantially all of its assets to another company. Supplee was 58 at the time. Supplee argued that the portion of his benefit – approximately \$298,046 – that would have been the early retirement penalty, but for the application of the change-in-control provision constituted severance pay and therefore was entitled to a priority. A severance payment is a form of compensation for termination of the employment relationship. The payment could only be an administrative expense “if the debtor received the consideration for the obligation after the commencement of bankruptcy proceedings.”

Judge Sotomayor affirmed the bankruptcy and district courts’ rulings that the early retirement benefit owed to Supplee was not an administrative expense, holding “the lump-sum payment itself represents the accelerated payment of benefits Supplee accrued over the course of his employment,” rather than “a new benefit earned at termination.” She analogized the payment BSC became obligated to make to Supplee under the SERPs as similar to the payment a debtor-in-possession has to make with regard to a withdrawal liability payment, stating that withdrawal liability payments are “the means by which the employer funds benefits that his employees have ‘earned’ by their past service and that he would normally finance through continuing contributions to his employees’ pension plan.” Relying on withdrawal liability case precedent, she stated that “regardless of when the debtor-in-possession’s obligation to pay the withdrawal liability arose, the payment represented an accelerated lump-sum contribution toward the benefits its employees had accrued over the course of their prepetition employment.” Thus, Judge Sotomayor concluded the payment was not an administrative expense because it was not a “new benefit earned at termination.”

*Supplee* required the application of legal analytical skills by Judge Sotomayor in a case where no significant legal precedent squarely on point existed to guide her decision. Her analysis was thorough, her reasoning was sound, and her application of analogous case authority related to withdrawal liability was apropos.

*Henry v. Champlain Enterprises Inc.*, 445 F.3d 610 (2nd Cir. 2006) involved a breach of fiduciary duty/prohibited transaction claim in connection with the sale of employer’s stock to an ESOP.

The central issue was whether the ESOP fiduciary, U.S. Trust, breached its fiduciary duty in determining that the consideration paid for the employer stock was adequate. Because the district court had focused nearly exclusively on the absence of notes from the fiduciary with regard to a single meeting with its independent valuation expert to the exclusion of nearly all other facts regarding the fiduciary's due diligence, Judge Sotomayor vacated the district court's decision and remanded the case for further proceedings consistent with her decision.

*Henry* came to the court of appeals after a bench trial in the district court. The case contains a long recitation of the underlying facts concerning the negotiations and the fiduciary's due diligence in connection with the transaction.

Under ERISA §408, there is a conditional exemption from the prohibited transaction rules for the acquisition of employer securities by ESOPs. Section 408(e) permits the sale of employer stock by a party in interest to an ESOP if the purchase is made for "adequate consideration." Where the stock is not publicly traded, ERISA defines "adequate consideration" as "the fair market value of the assets as determined in good faith by the trustee or named fiduciary pursuant to the terms of the plan and in accordance with regulations promulgated by the Secretary [of Labor]." ERISA §3(18)(B). The Department's proposed regulation provided a two part test: first, the value assigned to the asset must reflect its fair market value, and second, the value assigned must be the product of a determination made by the fiduciary in good faith. Both requirements must be satisfied in order for the DOL to conclude that a fiduciary determined adequate consideration in accordance with ERISA §3(18)(B).

Judge Sotomayor noted that "although fair market value and good faith are often stated as distinct requirements, they are closely intertwined" and stated that "[t]he role of the courts in reviewing the adequacy of consideration in an ERISA case is to determine whether the fiduciary can show that the price paid represented a good faith determination of the fair market value of the asset, 'not to redetermine the appropriate amount for itself *de novo*.'"

Judge Sotomayor reversed the district court's ruling that the ESOP engaged in a prohibited transaction by approving the transaction without adequate research. She noted that the district court had found that U.S. Trust failed to demonstrate that it had satisfied its obligations as an ERISA fiduciary because it produced insufficient documentation of the investigation it undertook in the months leading up to the ESOP transaction, focusing "entirely" on the absence of notes from U.S. Trust of a meeting it held with its independent valuation firm, Houlihan, Lokey, Howard & Zukin ("HLHZ"), but essentially disregarding all of the other evidence of its due diligence. Thus, she concluded "[t]he district court erred as a matter of law when it found that U.S. Trust failed to qualify for the §408 exception as a result of its failure to produce notes showing that it 'properly evaluated HLHZ's report, asked the difficult questions, and assessed the response to those questions. ... The focal point of our inquiry under ERISA is not whether a fiduciary took adequate notes of its investigation, but whether it acted with the prudence required of a fiduciary under the prevailing circumstances at the time of the transaction.'" Judge

Sotomayor then described the evidence which demonstrated that the fiduciary had identified as areas of concern in his copy of the preliminary valuation that were then reflected in HLHZ's detailed notes of that meeting "which gives rise to a strong inference that U.S. Trust raised these issues at the meeting." Also, U.S. Trust (i) reviewed HLHZ's preliminary valuation report, (ii) met with HLHZ to discuss its concerns, and (iii) saw the report changed in ways that reflected those concerns. U.S. Trust also negotiated significant improvements in the ESOP's position over the course of the negotiations which were incorporated into the final HLHZ valuation. Finally, Judge Sotomayor noted that "whether a fiduciary has made a proper determination of the 'fair market value' of an asset purchased by an ESOP depends on whether the parties are 'well-informed about the asset and the market for that asset,'" and that the district court had not identified any area where U.S. Trust was ill-informed about the securities purchased or the employer's market. Thus, she vacated the district court judgment and remanded for further proceedings consistent with the opinion.

The decision in *Henry* demonstrates not only a clear understanding of the relevant law regarding the determination of the adequate consideration exception to the prohibited transaction rules, but an understanding of the pragmatic application of those rules to the underlying facts. Her decision, again, reflected a comprehensive study of the record and analysis of the relevant law. In our view, the facts were developed to the point where Judge Sotomayor could have concluded that U.S. Trust dispatched its fiduciary duty consistent with the requirements of ERISA and the DOL with regard to determining adequate consideration, but instead, she chose the more conservative approach of thoroughly instructing the district court on the relevant law and remanding the case for further proceedings by the district court consistent with her opinion.

*Marcella v. Capital District Physicians' Health Plan Inc.*, 293 F.3d 42 (2nd Cir. 2002) involved a health insurance claim for wrongful refusal to reimburse the cost of a surgery. The issue of primary consequence in the case was whether the plan in question was an employee benefit plan under ERISA. Reversing the district court, Judge Sotomayor held that the claims did not relate to an ERISA plan, and therefore, there was no basis for federal jurisdiction. She returned the case to the district court with instructions to remand the action to state court.

Marcella purchased health insurance coverage from Capital District Physicians' Health Plan, Inc. ("CDPHP") under a group policy offered through the Latham Area Chamber of Commerce (the "Chamber"). She originally obtained the coverage as a real estate broker affiliated with Prudential Realty ("Prudential"). Prudential was a member of the Chamber. Marcella's application indicated that she was an employee of Prudential; however, she claimed that she was an independent contractor. Several years later, Marcella opened a new business and joined the Chamber as an individual member. She claimed that from that point forward, her access to the Chamber Plan was through her own membership. Whether as an enrollee through Prudential or her own business, Marcella paid all of the premiums in connection with the insurance.

When CDPHP refused to pay her surgery claim, Marcella filed the action in state court for breach of contract and intentional infliction of emotional distress. No ERISA claim was asserted. However, the insurer removed the case to federal court, contending the claims were subject to complete preemption under ERISA. The district court denied Marcella's motion to remand, and subsequently granted summary judgment for the insurer on the ground that the claims were preempted by ERISA.

Judge Sotomayor reversed, holding that group health plan coverage offered to members of the Chamber did not qualify as an ERISA-governed plan. She noted ERISA's definition of "employee benefit plan" states that such a plan must be "established or maintained by an employer." ERISA §3(1). Accordingly, the threshold question was whether the Chamber, which established and maintained the Plan, may be considered an employer for the purposes of ERISA. She held it could not. She reasoned that while plans offered by a "group or association" of employers may qualify as ERISA plans, there was no dispute that the Chamber was open not only to businesses but to sole proprietorships without employees (other than the owners) and such businesses logically could not be considered an "employer." She found support for this proposition in DOL Opinion Letters concluding that an association that is not limited solely to employers does not meet ERISA's definition of "employer," and held that the Chamber was not an "employer" under ERISA because membership was "open not only to businesses with employees but also to sole proprietorships without employees and to individuals." However, that did not conclude the analysis, as Judge Sotomayor reasoned that it was "possible that the Chamber Plan – or, rather, the terms of the policy offered by CDPHP to Chamber members – can form part of an ERISA plan should a Chamber member that is an employer choose to provide its employees with access to the Chamber Plan." Consequently, she further examined whether Marcella's participation in the health plan first through Prudential and then through her own company could provide a basis to conclude she participated in an employee benefit plan.

With regard to participation through her own business, Judge Sotomayor concluded that there could be no ERISA plan "for the simple reason that, under the regulations promulgated by the Department of Labor ..., a sole proprietor is not an "employee" for the purpose of ERISA." (Of course, under *Yates v. Hendon*, 541 U.S. 1 (2004), a sole proprietor may be a participant in an ERISA-qualified plan if the plan has at least one employee other than the owner and his or her spouse. Here, it appears Marcella's business had no other employees.) With regard to participation through Prudential, Judge Sotomayor concluded that, pursuant to DOL Reg. 2510.3-1(j), Prudential did not establish or maintain the plan because (i) it did not make contributions, (ii) participation was completely voluntary for its employees, (iii) its sole function with respect to the program was to permit the insurer to publicize the program to its employees, and (iv) Prudential received no consideration in connection with the program. Consequently, whether Marcella's coverage was maintained pursuant to her relationship with Prudential or through her own membership with the Chamber, Judge Sotomayor held it was not "part of" an ERISA plan. Accordingly, the district court lacked subject matter

jurisdiction and Marcella's motion to remand was improperly denied.

This case, as is true of the others, demonstrates Judge Sotomayor's attention to detail, thorough and tightly structured analysis, and the fact that her ERISA decisions are driven largely by existing case precedent, statute or relevant regulations.

*Layaou v. Xerox Corp.*, 238 F.3d 205 (2nd Cir. 2001) is the final published court of appeal opinion written by Judge Sotomayor. To the best of our knowledge, it was her first ERISA decision after elevation to the Second Circuit. It involved the adequacy of the Xerox Corporation's pension plan's summary plan description ("SPD") under ERISA. Judge Sotomayor held that the SPD was inadequate, violating ERISA because it failed to provide notice that future plan benefits were subject to reduction if an employee left the company, accepted a lump-sum distribution and then later returned to the company.

Under its Plan, Xerox had several methodologies for computing benefits and purported to provide its employee the benefit based on the calculation which yielded the highest result. For rehired employees, the number of years of service in the calculation included the total time the employee worked for Xerox, not just the period of employment following the rehire. However, under two of the methods of calculation, the plan administrator took into account the prior lump sum distribution of benefits upon the first termination and rather than simply subtracting out the value of the prior distribution, recalculated the benefit using what Xerox termed a "phantom account" offset. The phantom account offset essentially offset the employee's earned benefit by the value of a hypothetical account containing the original distributed sum plus the amount that distribution would have earned had it been invested – or what Judge Sotomayor referred to as the "appreciated amount of [the] prior distribution." Not only did the SPD fail to advise the participants of the offset for the appreciated amount of the period distribution, but the annual benefit statements participants received estimating their benefit were similarly silent with regard to the phantom account offset.

Layaou received from Xerox his 1994 yearly estimate of benefits prior to the effective date of his layoff. It indicated that his benefit under one of the forms of calculation was \$924 per month. He was later laid off, and in April 1995, his retirement became effective. The plan administrator recalculated his benefit. The net result after the application of the phantom account offset was that he was determined to be entitled to a benefit of \$145 per month. After pursuing his administrative remedies unsuccessfully, Layaou sued in the district court. Applying the abuse of discretion standard, the district court granted summary judgment, affirming the plan administrator's decision and concluding that "plaintiff has not presented a basis upon which a factfinder could reasonably conclude that the SPD precluded the Plan Administrator from reducing plaintiff's benefit amount based on the appreciated amount of the prior distribution in accordance with the terms of the Plan."

Judge Sotomayor vacated the decision and remanded. After reciting the basic statutory and regulatory provisions regarding SPD

requirements, she held that the Xerox SPD did not meet the ERISA's disclosure requirement, stating, "[w]e ... find, as a matter of law, that the SPD failed to provide notice to Layaou and other similarly situated employees that their future benefits would be offset by an appreciated value of their prior lump-sum benefits distributions." She noted, "The SPD does not mention the term 'phantom account,' describe the 'phantom account' offset concept, or even indicate that the choice among the three methods of calculating future benefits will be made by first adding on, and then later offsetting, not the amount of the prior distributions but instead an appreciated value of the prior lump-sum distributions." Thus, Judge Sotomayor held, "... we find that Xerox's SPD did not describe the 'full import' of the effect of receiving a prior lump-sum distribution on the calculation of further retirement benefits upon rehire, and therefore, did not meet the requirements of §1022. The SPD fails to 'clearly identify[y]' the 'loss ... of [ ] benefits' caused by a prior lump-sum distribution. 29 C.F.R. §2520.102(l)."

Demonstrating one of the consistent themes of her decisions – not to preempt the district court's initial review function – Judge Sotomayor remanded the case to the district court to decide in the first instance

whether Layaou must demonstrate reliance on and/or prejudice flowing from Xerox's faulty SPD in order to prevail on his ERISA §102(a) SPD claim, and if so, whether Layaou's statements in his declaration in opposition to the motion for summary judgment were sufficient to raise a triable issue of fact on the issue.

The analysis in *Layaou* was thorough. The decision is consistent with mainstream precedent concerning the requirements of SPDs.

As previously noted, in addition to the foregoing cases, there are a significant number of ERISA-related decisions in which Judge Sotomayor participated as a member of the three-judge Second Circuit panel, but did not write the opinion of the court. Several are identified below<sup>1</sup>.

In our next bulletin on Judge Sotomayor's ERISA decisions, we will review several of her district court level decisions. Because decisions rendered on a district court level are not the product of the consensus required from an appellate court panel, they can sometimes be more representative of the specific judge than his or her appellate opinions. ❖

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<sup>1</sup>*Celardo v. GNY Automobile Dealers Health & Welfare Trust*, 318 F.3d 142 (2nd Cir. 2003) (plan administrator did not abuse discretion when it denied coverage for injuries sustained by a plan participant who was cited for several traffic infractions; finding it was reasonable for the administrator to interpret the "illegal acts" exclusion to include traffic infractions); *Metropolitan Life Insurance Co. v. Bigelow*, 283 F.3d 436, (2nd Cir. 2002) (marital property settlement agreement requiring a General Electric Co. employee to name his daughters as beneficiaries of his employee benefit plans met the requirements of a qualified domestic relations order; plan administrators not require to determine whether an order is a QDRO before a federal court may do so); *Abbruscato v. Empire Blue Cross and Blue Shield*, 274 F.3d 90 (2nd Cir. 2001) (employee welfare plan SPD that contained a promise of lifetime benefits and a reservation of rights clause, did not guarantee lifetime benefits for employees who retired after the SPD went into effect); *Kinstier v. First Reliance Standard Life Insurance Co.*, 181 F.3d 243 (2nd Cir. 1999) (*de novo* standard of review applicable to benefit claim unless clear grant of discretion to the insurer); *EklecCo v. Iron Workers Locals 40, 361, & 417 Union Security Funds*, 170 F.3d 353 (2nd Cir 1999) (New York's mechanic's lien law preempted by ERISA); *Joyce v. Curtiss-Wright Corp.*, 171 F.3d 130 (2d Cir. 1999) (employee welfare plan benefits not vested and could be terminated based on reservation of rights clause in SPD and termination language in CBA).

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