CLIENT UPDATE

COURT REJECTS ERISA CHALLENGE TO PENSION DE-RISKING TRANSACTION

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For many employers, underfunded defined benefit pension plans present significant ongoing challenges. These challenges arise not only because of the underfunding itself, but also because of the significant volatility that the underfunding can create on its balance sheet due to changes in interest rates and other key assumptions over time. An employer has always had the ability to seek to improve its longer-term financial profile by "de-risking" its pension plan through the purchase of an annuity from a suitable annuity provider that commits to pay benefits to plan participants without further financial support from the employer. The transfer of pension obligations in this manner, which may include the termination or partial termination of the pension plan, can significantly improve an employer's financial profile. De-risking transactions have become more prominent in recent months because of two transformative transactions, one involving General Motors and the other involving Verizon. We are pleased to report that the first judicial test of these transactions in court under ERISA, the Federal benefits statute, has resulted in a victory for the parties involved in the transaction. And, while the decision was based only on a request for preliminary injunctive relief, and while future litigation will be based on the manner in which future de-risking transactions are structured (including on the key issue of annuity provider selection and suitability), the decision validates the central thesis of pension de-risking and provides an important and helpful roadmap through some of the potential ERISA challenges to these transactions.

In a recent transaction, Verizon Communications Inc. ("Verizon") completed a partial de-risking of the Verizon Management Pension Plan (the "Plan") by settling approximately $7.5 billion of the Plan's pension obligations through the purchase of a single premium group annuity contract (the "GAC") from The Prudential Insurance Company of America ("Prudential"). Under the terms of the GAC, approximately 41,000 Verizon retirees will receive annuity payments from Prudential in form and amount, including rights to future payment (e.g., survivor benefits), identical to those they received under the Plan. Verizon amended, but did not terminate, the Plan in connection with the transaction.

Prior to the scheduled closing of the GAC purchase, a small group of Plan participants ("Plaintiffs") sued to enjoin the transaction on ERISA grounds, but on December 7, 2012, the U.S. District Court for the Northern District of Texas denied Plaintiffs' attempt to prevent Verizon's purchase of the GAC, finding that the Plaintiffs' claims had little likelihood of success on the merits.[1] In particular, the Court rejected arguments that Verizon violated the disclosure, fiduciary and anti-discrimination claims raised under ERISA.

GROUNDS FOR DENIAL

No Failure to Disclose

One feature of the GAC is that retirees will receive benefits in the same form and amount that they would have received pursuant to the Plan. While Plaintiffs argued that Verizon had failed to disclose this event as a circumstance which may result in a "loss of benefits" that is required to be described in the Plan's summary plan description, the Court found that there is no "loss of benefits" to the retirees as a result of Verizon's transfer of the Plan's pension obligations to Prudential because the GAC provides for the continued payment of benefits previously provided under the Plan. The Court further explained that ERISA requires the summary plan description to describe current plan terms, but not to disclose changes that may occur or the possibility of changes. Noting also the extended period for a plan administrator to inform participants of changes to a plan, the Court implied that the Plaintiffs would have great difficulty in prevailing on a nondisclosure claim related to the summary plan description. The Court also rejected the Plaintiffs' assertion that the absence of disclosure in the current summary plan description regarding a potential transaction breached a general duty to inform participants of material information, noting that there is no affirmative duty to disclose the possibility of future plan changes.

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1 *Lee v. Verizon Communications Inc.*, 12-cv-4834, U.S. District Court, Northern District of Texas (Dallas).

No Breach of Fiduciary Duty

Plaintiffs contended that Verizon violated its ERISA fiduciary duties when it amended the Plan to authorize the purchase of the GAC, but the Court found that Verizon was acting in its capacity as a settlor in making that decision, and therefore ERISA fiduciary duties did not apply. The Court also found that ERISA's duty to diversify pension investments does not apply to the selection of a single annuity provider because the purchase of the GAC constituted a distribution of benefits (and not an investment) and was permissible under the terms of the Plan.

No Interference

Lastly, the Court found that Verizon did not unlawfully interfere with the Plaintiffs' attainment of rights under the Plan or ERISA when it chose to transfer to Prudential the Plan's obligations with respect to only a subset of all Plan participants. Verizon, the Court noted, offered legitimate non-discriminatory reasons for defining the group of affected Plan participants. Verizon explained that it selected a group of retirees who began receiving fixed benefit payments on or before January, 2010 (so called "stable pension obligations") because this simplified and reduced the cost of the GAC. Doing so, the Court found, did not deprive these retirees of their rights under the Plan or ERISA.

PRUDENT SELECTION OF ANNUITY PROVIDER NOT CHALLENGED

While finding no merit in the ERISA challenges, the Court correctly emphasized an employer's fiduciary duty in de-risking transactions to act prudently when selecting an annuity provider. Thus, while the decision to annuitize the Plan, whether for some or all participants, did not raise questions of fiduciary duty, the choice of which annuity to purchase will. Such a claim was not tested in the Verizon litigation, as the Plaintiffs did not contest the choice of Prudential as an annuity provider.

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We expect other companies to continue to pursue similar transformative pension de-risking transactions given their financial advantages, and now that the landscape of these transactions under ERISA is becoming more settled. Please do not hesitate to contact us with any questions.

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