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By T. Geoffrey Lieben\*

# The Coverage of Title I of ERISA: Some Recent Developments

## I. INTRODUCTION

Employee benefit plans have a significant and growing impact on the population of the United States. It is estimated that nonfederal retirement funds currently hold in excess of \$750 billion in assets.<sup>1</sup> Total retirement, disability, and survivor benefits increased from two percent of the gross national product in 1950 to over eight percent in 1975.<sup>2</sup> Benefit plans and their administration materially affect the capital markets, the development of industrial relations, the stability of employment, and the well being of millions of employees and their dependents.<sup>3</sup>

Prior to 1974, federal regulation regarding benefit plans was somewhat piecemeal and was primarily directed at specifically identified potential abuses. In the Revenue Act of 1942,<sup>4</sup> Congress established general guidelines for the design and operation of tax-qualified pension and profit sharing plans. Rather than attempting to regulate such plans, however, the 1942 Revenue Act was designed: (1) to prevent discrimination in favor of officers, shareholders, supervisors, and highly compensated individuals; and (2) to protect federal revenues from excessive or unwarranted tax deductions.<sup>5</sup> Congress retained the basic structure established by the Revenue Act of 1942 in the Internal Revenue Code of 1954.<sup>6</sup>

A second federal enactment affecting the employee benefit area was the Labor Management Relations (Taft-Hartley) Act of 1947.<sup>7</sup> That statute imposed restrictions on employee benefit plans for

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\* Partner, Fitzgerald, Brown, Leahy, Strom, Schorr & Barmettler, Omaha, Nebraska; J.D., New York University, 1971.

1. Pens. & Inv. Age, Dec. 7, 1981, at 1, col. 3.

2. PRESIDENT'S COMMISSION ON PENSION POLICY, COMING OF AGE: TOWARD A NATIONAL RETIREMENT INCOME POLICY, *reprinted in*, 32 PENS. & PROFIT SHARING (P-H) 13 (Mar. 6, 1981).

3. 29 U.S.C. § 1001 (1976).

4. Pub. L. No. 77-753, 56 Stat. 798 (1942).

5. Revenue Act of 1942, Pub. L. No. 77-753, § 162, 56 Stat. 862.

6. See I.R.C. §§ 401-404 (1976 & Supp. IV 1980).

7. Pub. L. No. 80-101, 61 Stat. 136 (1947).

union employees. Section 302(c)(5)<sup>8</sup> of the Act provided that as long as an employer made employee benefit contributions to a trust that was jointly administered by union and employer representatives and that met certain other requirements,<sup>9</sup> the employer would not violate the Act's general prohibition against paying anything of value to representatives of his employees.<sup>10</sup> However, section 302(c)(5) only established a framework for the joint administration by labor and management of pension and welfare funds. It did not comprehensively regulate the funds, their administration, or the benefits themselves.

The other significant federal enactment regarding employee benefit plans prior to 1974 was the Welfare and Pension Plan Disclosure Act (WPPDA) enacted by Congress in 1958.<sup>11</sup> It contained certain plan reporting and disclosure requirements and also established civil and criminal sanctions for improper use of plan assets.<sup>12</sup> The basic purpose of the WPPDA was to protect employee benefit plan assets from fraudulent or criminal behavior by forcing disclosure of the activities of those in charge of the plan and its assets.<sup>13</sup> The Act was not designed to preserve the rights of individual participants to those assets.

In 1974 Congress enacted the Employee Retirement Income Security Act (ERISA).<sup>14</sup> As the Supreme Court has stated, ERISA is "comprehensive and reticulated."<sup>15</sup> The interwoven regulatory scheme in the Act preempts the entire field of regulation with respect to almost every aspect of employee benefits.<sup>16</sup> Unlike prior federal regulation, ERISA is directed specifically at the protection

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8. 29 U.S.C. § 186(c)(5) (1976 & Supp. IV 1980). For a recent decision regarding the interrelationship between section 302(c)(5) of the Labor Management Relations Act of 1947 and the Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, 88 Stat. 829 (1974) (codified at scattered sections of 26 & 29 U.S.C. (1976 & Supp. IV 1980)), see *NLRB v. AMAX Coal Co.*, 453 U.S. 322 (1981).

9. See 29 U.S.C. § 186(c)(5) (1976 & Supp. IV 1980).

10. The general prohibition is set forth at 29 U.S.C. § 186(a) (1976).

11. Pub. L. No. 85-836, 72 Stat. 997 (1958) (codified at 29 U.S.C. §§ 301-309 (1976)). The WPPDA was repealed by ERISA § 111(b)(2), 29 U.S.C. § 1031(b)(2) (1976).

12. 29 U.S.C. §§ 305-307 (1976).

13. See *id.* § 301.

14. Employment Retirement Income Security Act of 1974, Pub. L. No. 93-406, 88 Stat. 829 (codified at scattered sections of 26 & 29 U.S.C. (1976 & Supp. IV 1980)).

15. *Alessi v. Raybestos-Manhattan, Inc.*, 451 U.S. 504, 510 (1981); *Nachman Corp. v. Pension Benefit Guar. Corp.*, 446 U.S. 359, 361 (1980).

16. Section 514(a) of ERISA provides that ERISA supersedes all state laws "insofar as they may now or hereafter relate to any employee benefit plan." 29 U.S.C. § 1144(a) (1976). See *Lederman v. Pacific Mut. Life Ins. Co.*, 494 F. Supp. 1020, 1022 (C.D. Cal. 1980), and *infra* note 32.

of employees and the guaranteeing of their benefits. It is a "pro-employee" act designed to provide a wide variety of safeguards and minimum standards with respect to the establishment, operation, and administration of benefit plans.<sup>17</sup> The Act is massive in both dimension and detail because of the scope of the matters covered and the specificity with which Congress determined to regulate employee benefits.

Title I of ERISA sets forth the basic regulatory framework for the protection of employee benefit rights.<sup>18</sup> It imposes comprehensive reporting and disclosure requirements,<sup>19</sup> minimum funding standards,<sup>20</sup> minimum vesting and participation standards,<sup>21</sup> fiduciary responsibility rules,<sup>22</sup> and a system for civil and criminal enforcement.<sup>23</sup> The extent of the coverage of Title I is the subject of this Article.

## II. SCOPE OF TITLE I COVERAGE

Coverage of a particular employee benefit plan by ERISA<sup>24</sup> has several important ramifications. Among the most significant are the reporting and disclosure requirements<sup>25</sup> and the substantial civil and criminal penalties for failure to comply,<sup>26</sup> but there are many others.<sup>27</sup> For example, in a suit by an employee for plan benefits, ERISA coverage affects procedural matters such as the abil-

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17. *Fine v. Semet*, 514 F. Supp. 34, 41 (S.D. Fla. 1981); 29 U.S.C. § 1001 (1976).

18. 29 U.S.C. §§ 1001-1144 (1976 & Supp. IV 1980). ERISA consists of four separate titles. Title II is primarily concerned with the qualification requirements for tax-qualified pension and profit sharing plans. ERISA, Pub. L. No. 93-406, §§ 1001-2008, 88 Stat. 829 (1974) (codified at scattered sections of 26 U.S.C. (1976 & Supp. IV 1980)). In form it is an amendment to the Internal Revenue Code. Title III sets forth procedures to be followed by the Secretaries of Treasury and Labor in the joint administration of the Act. 29 U.S.C. §§ 1201-1242 (1976 & Supp. IV 1980). Title IV establishes a program of plan termination insurance, the basic purpose of which is to insure payment of vested benefits to employees covered by defined benefit pension plans. *Id.* §§ 1301-1381.

19. 29 U.S.C. §§ 1021-1031 (1976).

20. *Id.* §§ 1081-1086.

21. *Id.* §§ 1051-1061.

22. *Id.* §§ 1101-1114.

23. *Id.* §§ 1131-1144.

24. *See infra* notes 38-45 and accompanying text.

25. 29 U.S.C. §§ 1021-1031 (1976).

26. *Id.* §§ 1131-1141.

27. Some less significant ramifications are the necessity for bonding with a surety company, *id.* § 1112; the requirement that the plan be in writing, *id.* § 1102(a)(1), and the necessity for the adoption of a claims procedure for the plan. *Id.* § 1133.

ity to litigate in federal court,<sup>28</sup> the recovery of attorneys fees<sup>29</sup> and punitive damages,<sup>30</sup> the availability of a jury trial,<sup>31</sup> and the preemption of state laws.<sup>32</sup> Perhaps of more consequence, ERISA coverage also affects substantive matters regarding the operation of the plan itself, such as whether the plan must be funded on a current basis<sup>33</sup> and the duties owed to the employees by the employer and others with respect to the plan.<sup>34</sup>

The latter requirement can be particularly material. ERISA has created a new federal system of fiduciary standards and duties which apply to substantially all covered plans. Many actions respecting employee benefit plans, which prior to 1974 were measured by state contract law principles of reasonableness, are now simply prohibited.<sup>35</sup> Moreover, an entirely new federal common law is to be developed, taking into account the special nature of

28. *Id.* § 1132(e); *Murphy v. Inexco Oil Co.*, 611 F.2d 570 (5th Cir. 1980). *See infra* note 63.

29. *Dependahl v. Falstaff Brewing Corp.*, 653 F.2d 1208 (8th Cir.), *cert. denied*, 102 S. Ct. 512 (1981) (attorney fees are recoverable). *See also* *San Pedro Fisherman's Welfare Trust Fund Local 33 v. Di Bernardo*, 664 F.2d 1344 (9th Cir. 1982); *National Stabilization Agreement v. Commercial Roofing & Sheet Metal*, 655 F.2d 1218 (D.C. Cir. 1981).

30. *Dependahl v. Falstaff Brewing Corp.*, 653 F.2d 1208 (8th Cir. 1981), *cert. denied*, 102 S. Ct. 512 (1981) (as a matter of federal common law punitive damages are inappropriate).

31. *Compare Wardle v. Central States, Southeast & Southwest Areas Pension Fund*, 627 F.2d 820 (7th Cir. 1980), *cert. denied*, 449 U.S. 1112 (1981) (no jury trial in suit for plan benefits) *with* *Stamps v. Michigan Teamsters Joint Council No. 43*, 431 F. Supp. 745 (E.D. Mich. 1977) (jury trial available under ERISA).

32. Under 29 U.S.C. § 1144(a) (1976), ERISA supersedes all state laws that "relate to" employee benefit plans. This has been interpreted by one court to mean that a pendent claim of tortious interference with employee benefit plans cannot be made. *Dependahl v. Falstaff Brewing Corp.*, 653 F.2d 1208, 1216 (8th Cir.), *cert. denied*, 102 S. Ct. 512 (1981). Another court has concluded that ERISA does not preempt a pendent claim of fraudulent misrepresentation of the nature of benefits under a medical plan and a claim for intentional infliction of emotional distress with respect thereto. *Provience v. Valley Clerks Trust Fund*, 509 F. Supp. 388, 392 (E.D. Cal. 1981).

The entire area of federal preemption of state law by ERISA has been the subject of numerous conflicting opinions. *Compare* *Standard Oil Co. of California v. Agsalud*, 633 F.2d 760 (9th Cir. 1980), and *General Split Corp. v. Mitchell*, 523 F. Supp. 427 (E.D. Wis. 1981), *with* *Delta Air Lines, Inc. v. Kramarsky*, 650 F.2d 1287, *vacated on rehearing*, 666 F.2d 21 (2d Cir. 1981), and *Westinghouse Elec. Corp. v. State of Maryland Comm'n.*, 520 F. Supp. 539 (D. Md. 1981). The Supreme Court's recent decision in *Alessi v. Raybestos-Manhattan, Inc.*, 451 U.S. 504 (1981), may clear up some of the confusion in this area by its holding that the phrase "relate to any employee benefit plan" in 29 U.S.C. § 1144(a) (1976) is to be broadly construed.

33. 29 U.S.C. §§ 1081-1086 (1976).

34. *Id.* §§ 1101-1114.

35. *Id.* § 1106. *See supra* note 32.

employee benefit plans.<sup>36</sup> The current undeveloped nature of this new common law leaves employers in a state of uncertainty, especially with respect to their fringe benefit and nonqualified retirement plans<sup>37</sup> which, for most employers, were never subject to any degree of regulation.

Title I applies to employee benefit plans affecting commerce<sup>38</sup> that are "established or maintained" by an employer or employee organization.<sup>39</sup> Exempted are the broad categories of governmental plans,<sup>40</sup> church plans,<sup>41</sup> and a few enumerated specialized types of plans.<sup>42</sup> The term "employee benefit plan" is divided into two distinct types of plans—the "employee welfare benefit plan" and the "employee pension benefit plan."<sup>43</sup>

Section 3(1) of ERISA broadly defines an "employee welfare

36. In *Amato v. Bernard*, 618 F.2d 559, 567 (9th Cir. 1980), the court stated: "We note first that in enacting ERISA, Congress intended that a body of Federal substantive law will be developed by the courts to deal with issues involving rights and obligations under private welfare and pension plans." Likewise, in *Freund v. Marshall & Ilsley Bank*, 485 F. Supp. 629, 635 (W.D. Wis. 1979), the court stated: "[T]he intent of Congress was to federalize the common law of trusts applied in view of the special nature and purpose of employee benefit plans."

37. For a discussion of nonqualified retirement and deferred compensation programs, see *infra* text accompanying notes 68-93.

38. 29 U.S.C. § 1003(a) (1976). "Commerce" is broadly defined by the statute, *id.* § 1002(11) (1976), as "trade, traffic, commerce, transportation, or communication between any State and any place outside thereof," and has been broadly interpreted by the Department of Labor. See Pension & Welfare Benefit Program Op. Let. 77-36, summarized at [1979-1981 Transfer Binder] PENS. PLAN GUIDE (CCH) ¶ 25,304.

39. 29 U.S.C. § 1003(a) (1976). The term "employee organization" is defined as "any labor union or any organization of any kind, or any agency or employee representation committee, association, group, or plan, in which employees participate and which exists for the purpose, in whole or in part, of dealing with employers concerning an employee benefit plan, or other matters incidental to employment relationships; or any employees' beneficiary association organized for the purpose in whole or in part, of establishing such a plan." *Id.* § 1002 (4).

40. *Id.* § 1003(b)(1). A "governmental plan" is any plan established or maintained by any government, political subdivision, or agency or instrumentality thereof. *Id.* § 1002(32). It includes plans collectively bargained between a union and a governmental entity. Pension & Welfare Benefit Program Op. Let. 79-83, summarized at [1979-1981 Transfer Binder] PENS. PLAN GUIDE (CCH) ¶ 25,295.

41. 29 U.S.C. § 1003(b)(2) (1976). A church plan is basically a plan established by a tax-exempt church or convention of churches. *Id.* § 1002(33).

42. Also excluded from all of ERISA's provisions are workmen's compensation plans, plans maintained outside the United States for nonresident aliens, and unfunded plans designed to provide retirement benefits in excess of the limits set forth in section 415 of the Internal Revenue Code. 29 U.S.C. § 1003(b)(3)-(5) (1976).

43. *Id.* § 1002(3).

benefit plan" as a "plan, fund, or program" established or maintained for the purpose of providing: "(A) medical, surgical, or hospital care benefits, or benefits in the event of sickness, accident, disability, death or unemployment, or vacation benefits, apprenticeship or other training programs, or day care centers, scholarship funds, or prepaid legal services, or (B) any benefit described in section 302(c) of the Labor Management Relations Act, 1947 . . . ." <sup>44</sup> An "employee pension benefit plan" under section 3(2) of ERISA is a plan, fund, or program which "provides retirement income to employees" or "results in a deferral of income by employees extending to the termination of covered employment or beyond." <sup>45</sup>

Substantially all of ERISA's Title I provisions extend to pension plans which are qualified under section 401(a) of the Internal Revenue Code. <sup>46</sup> Practitioners have become well versed in the applicability of ERISA to those plans. However, with respect to employee welfare benefit plans and pension plans which are not tax-qualified, the extension of ERISA's coverage may lead to unexpected results.

ERISA's definition of employee benefit plans is to be broadly interpreted. One court, noting that "ERISA is a comprehensive remedial statute designed to protect the pensions and other benefits of employees," <sup>47</sup> concluded: "With such a statute, a liberal construction is warranted in order to carry out the statute's remedial purposes, . . . and coverage should be extended to provide the maximum degree of protection to employees." <sup>48</sup> Despite this expansive rule of interpretation, it is obvious that not all arrangements benefiting employees are covered by ERISA or by all of its provisions.

### III. EMPLOYEE WELFARE BENEFIT PLANS

The Department of Labor has issued final regulations regarding the applicability of ERISA to certain types of employment prac-

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44. *Id.* § 1002(1). The reference to the Labor Management Relations Act is made to include within the definition of welfare benefit plans those plans which provide holiday and severance benefits and similar benefits. Labor Management Relations Act, § 302(c), 29 U.S.C. § 186(c) (1976).

45. 29 U.S.C. § 1002(2) (1976).

46. A tax-qualified plan is basically one for which the contributing employer receives a current tax deduction for contributions to a trust or insurance annuity contract and the employee defers the reporting of income until funds are actually received by him from the plan or trust. Detailed and complicated rules are set forth in the Code regarding the qualification requirements. See I.R.C. §§ 401-415 (1976 & Supp. IV 1980).

47. *Freund v. Marshall & Ilsley Bank*, 485 F. Supp. 629, 654 (W.D. Wis. 1979).

48. *Id.*

tices.<sup>49</sup> With respect to welfare benefit plans, the regulations make it clear that ERISA does not apply to what are essentially payroll practices such as overtime pay, shift premiums, holiday premiums, and weekend premiums.<sup>50</sup> Also, where payments are made from the general assets of the employer, the regulations exclude payments of sick pay, vacation pay, and pay during jury or military duty.<sup>51</sup> A number of practices not specifically within the definition of a welfare plan are also excepted. These include on-premises recreation and dining facilities, holiday gifts, remembrance funds, sales of goods to employees (whether at a discount or at market), hiring halls, strike funds, and industry advancement programs.<sup>52</sup> The regulations make it clear that the listed exceptions from coverage are not all-inclusive.<sup>53</sup>

Further guidance as to the scope of ERISA coverage has come in the form of advisory opinions issued from time to time by the Department of Labor. The Department has expressed its opinion that payments of holiday and vacation pay benefits from a separately maintained fund<sup>54</sup> and a death benefit fund accumulating contributions of union members to pay death benefits<sup>55</sup> are both covered welfare benefit plans. It has also opined in conformity with the above-referenced regulations that an employer's payment of compensation from its general assets during an employee's sick leave is not a welfare benefit plan.<sup>56</sup>

A key requirement for coverage is that the plan, fund, or program be "established or maintained" by an employer or employee organization.<sup>57</sup> Thus, insurance contracts or funds made available by organizations to employers and employee organizations are not themselves employee benefit plans.<sup>58</sup> Rather, each employer or

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49. 29 C.F.R. § 2510.3 (1981).

50. *Id.* § 2510.3-1(b)(1).

51. *Id.* § 2510.3-1(b)(2)-(3).

52. *Id.* § 2510.3-1(c)-(i).

53. *Id.* § 2510.3-1(a)(4).

54. Pension & Welfare Benefit Program Op. Let. 79-4A, summarized at [1979-1981 Transfer Binder] PENS. PLAN GUIDE (CCH) ¶ 25,304.

55. Pension & Welfare Benefit Program Op. Let. 79-16, summarized at [1979-1981 Transfer Binder] PENS. PLAN GUIDE (CCH) ¶ 25,304. Under the plan, each participating union member contributed \$5.00 initially plus an additional \$3.00 when a member died. The death benefit equaled \$2.65 times the number of members.

56. Pension & Welfare Benefit Program Op. Let. 80-44A, summarized at [1979-1981 Transfer Binder] PENS. PLAN GUIDE (CCH) ¶ 25,367. *See* 29 C.F.R. § 2510.3-1(b)(2) (1981).

57. 29 U.S.C. § 1002(1)-(2) (1976).

58. *Taggart Corp. v. Life & Health Benefits Admin. Inc.*, 617 F.2d 1208 (5th Cir. 1980), *cert. denied*, 450 U.S. 1030 (1981) (proprietary enterprise offering ability to small employers to combine together to obtain group insurance rates not covered by ERISA); Pension & Welfare Benefit Program Op. Let. 78-4A, sum-



employee organization funding a plan with an insurance contract or fund would be establishing its own separate employee welfare benefit plan.<sup>59</sup> Moreover, if the benefit is simply offered by the insurer directly to employees, there is no ERISA coverage.<sup>60</sup>

The effect of the "established or maintained" requirement can be clearly seen in the recent case of *Lederman v. Pacific Mutual Life Insurance Co.*<sup>61</sup> In that case, an employee brought suit for health benefits against an insurer who provided benefits under a group insurance contract with the plaintiff's employer. The insurer sought to remove the case to federal court. Since the suit was not against either the plan, the employer, or any fiduciary of the plan, and since the contract itself was not a "plan, fund or program,"<sup>62</sup> the federal court held that the complaint was not subject to ERISA's civil enforcement provisions and returned the case to state court.<sup>63</sup> The court also rather broadly questioned the general scope of ERISA coverage when it stated:

I cannot believe that Congress intended that every claim against the insurance company under an employer's group health insurance plan should be a potential item of litigation in federal court. The policy declaration in the first section of ERISA (29 U.S.C. § 1001) shows that Congress was concerned about the fairness and financial soundness and stability of the employee benefit plans that had been increasing so rapidly in size,

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marized at [1979-1981 Transfer Binder] PENS. PLAN GUIDE (CCH) ¶ 25,304, (legal services program); Pension & Welfare Benefit Program Op. Let. 80-10A, summarized at [1979-1981 Transfer Binder] PENS. PLAN GUIDE (CCH) ¶ 25,341 (prototype health plan). See also *Insurance & Prepaid Benefits Trusts v. Marshall*, 90 F.R.D. 703 (C.D. Cal. 1981).

59. Pension & Welfare Benefit Program Op. Let. 80-10A, summarized at [1979-1981 Transfer Binder] PENS. PLAN GUIDE (CCH) ¶ 25,341.

60. See 29 C.F.R. § 2510.3-1(j) (1981). The Department of Labor specifically exempts from coverage group or group type insurance programs offered by an insurer to employees under which: (1) no contributions are made by an employer or employee organization; (2) participation is completely voluntary; (3) the sole functions of the employer or employee organization are, without endorsing the program, to permit the insurer to publicize the program and to collect premiums and remit them to the insurer; and (4) the employer or employee organization receives no consideration other than reasonable compensation for administrative services. *Id.*

61. 494 F. Supp. 1020 (C.D. Cal. 1980).

62. 29 U.S.C. § 1002(1)-(2) (1976).

63. 494 F. Supp. at 1023. The court also noted that because state and federal courts have concurrent jurisdiction of claims for benefits under ERISA (29 U.S.C. § 1132(e)(1) (1976)), the plaintiff should have the choice of forum. *Id.* This conclusion is questionable. In *McConnell v. Marine Eng'rs Beneficial Ass'n Benefit Plans*, 526 F. Supp. 770 (N.D. Cal. 1981), the court held that under 28 U.S.C. § 1441(a) (1976), a defendant has a right to remove to federal court an action for benefits under ERISA, since such actions are under the concurrent jurisdiction of the state and federal courts and there is no express prohibition in ERISA against removal.

scope and number.<sup>64</sup>

In the context of the case, the court's conclusion was correct since the claim was made against the insurance company, not the employer or the plan. On the other hand, the court's implied finding that claims for employee benefits should not be generally subject to federal jurisdiction is clearly incorrect. The Act specifically confers federal jurisdiction regarding claims for employee plan benefits,<sup>65</sup> and the legislative history of the Act shows that broad federal jurisdiction over all claims is precisely what Congress intended.<sup>66</sup> Moreover, under certain circumstances, suits directly against insurance companies are permitted under ERISA.<sup>67</sup>

#### IV. NONQUALIFIED RETIREMENT AND DEFERRED COMPENSATION PROGRAMS

In addition to pension and profit sharing plans that are qualified under the Internal Revenue Code, employers have long provided to their employees a wide variety of non-tax-qualified deferred compensation arrangements.<sup>68</sup> If such plans are covered by ERISA as "employee pension benefit plans,"<sup>69</sup> the results can be dramatic. All "employee pension benefit plans" are automatically subject to the minimum funding standards and vesting standards of ERISA.<sup>70</sup> Consequently, pay-as-you-go<sup>71</sup> or terminally funded<sup>72</sup>

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64. 494 F. Supp. at 1022.

65. 29 U.S.C. § 1132(e) (1976).

66. H.R. CONF. REP. NO. 1280, 93d Cong., 2d Sess. 327, *reprinted in* 1974 U.S. CODE CONG. & AD. NEWS 5038, 5107, states that suits to enforce benefit rights under the plan or to recover benefits under the plan "are to be regarded as arising under the laws of the United States in similar fashion to those brought under section 301 of the Labor-Management Relations Act of 1947." See *Amato v. Bernard*, 618 F.2d 559 (9th Cir. 1980), and *Chastain v. Delta Air Lines, Inc.*, 496 F. Supp. 979 (N.D. Ga. 1980), for examples of decisions involving claims for benefits under ERISA.

67. Such a suit was involved in *Eversole v. Metropolitan Life Ins. Co.*, 500 F. Supp. 1162 (C.D. Cal. 1980). In that case, the summary plan description for the group health insurance plan stated that the insurer was the plan fiduciary in charge of benefit claims. Based on this provision, the court found that the insurance company was a fiduciary subject to the provisions of 29 U.S.C. §§ 1101-1114 (1976) and suit could be brought in federal court directly against it. 500 F. Supp. at 1166.

68. A non-tax-qualified plan is one which does not meet one or more of the strict requirements of sections 401-415 of the Internal Revenue Code.

69. See *supra* text accompanying note 45.

70. 29 U.S.C. §§ 1051, 1081 (1976).

71. Under a pay-as-you-go plan, the employer pays each retired worker's monthly pension as each payment becomes due. There is no accumulation of pension funds in a trust or through a contract or policy with an insurance company. E. ALLEN, J. MELONE, J. ROSENBLUM, *PENSION PLANNING* 162-63 (4th ed. 1981).

72. Under a terminal funding approach, the employer sets aside for each em-

plans are not permitted under ERISA.

Many pay-as-you-go or terminally funded plans existed prior to the enactment of ERISA. Pursuant to their terms employers would pay retirement benefits, often on an *ad hoc* basis only, to employees who actually retired at a normal retirement date or had completed a long period of service. Often an employer established such a plan solely to provide a supplement to profit sharing benefits for older employees who did not have sufficient participation in the qualified profit sharing plan to accumulate an adequate retirement benefit. Employees who terminated prior to retirement or prior to the required length of employment would receive nothing under such plans. Other arrangements were no more than gratuities paid to retiring employees. ERISA's funding and vesting requirements essentially eliminated all of these plans.<sup>73</sup>

Additionally, by requiring that all pension plans be funded, ERISA has a substantial negative income tax effect on participants in nonqualified deferred compensation plans. Under applicable tax rules, a participant in a nonqualified funded deferred compensation plan must report employer contributions as income when his interest under the plan becomes vested.<sup>74</sup> Requiring funding of such plans thus, unfortunately, also requires employees to pay taxes on funds they will possibly not receive for many years.

Not all deferred compensation plans must be funded. ERISA makes an important exception to the vesting, participation, funding, and fiduciary responsibility rules for "unfunded" plans maintained by an employer "primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees."<sup>75</sup> Presumably Congress created this exception since managerial and highly compensated employees have more opportunity to fend for themselves in protecting their rights to benefits. The exception is important, as it allows employers to grant key employees equity plans such as incentive and nonqualified stock options, phantom stock plans, and performance share plans.<sup>76</sup> Such plans and similar ones are often key factors in the attraction and retention of executives.

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ployee on his retirement date a lump sum amount sufficient to provide the monthly pension benefit promised. As under the pay-as-you-go approach, terminal funding does not require the employer to make any contributions on behalf of employees who are still actively at work. *Id.* at 163.

73. See 29 C.F.R. § 2510.3-2(e) (1981).

74. See I.R.C. § 402(b) (1981); 26 C.F.R. § 402(b)(1) (1981); I.R.C. § 403(c) (1981); 26 C.F.R. § 403(c)(1) (1981).

75. 29 U.S.C. §§ 1051(2), 1081(a)(3), 1101(a)(1) (1976).

76. See Wingfield, "Equity" Type Compensation Arrangements: A Comparative Analysis, 32 N.Y.U. INST. FED. TAX'N 983 (1974), for a discussion of these types of plans.

Availability of the exception depends on the definition of two terms—"unfunded" and "highly compensated." The term "unfunded" is not defined by ERISA but has a well-established meaning in the employee benefits area, primarily deriving from the tax law interpretation of the term. To speak of a "funded" plan basically is to refer to a nonqualified plan under which the deferred compensation is irrevocably contributed by the employer to a separate fund, e.g., a trust, a group annuity contract, or an escrow account.<sup>77</sup> The key element is that the employer cannot recoup its contribution. The individual employee may forfeit his right to his portion of the fund which will be distributed among other participants,<sup>78</sup> but the employer cannot recover its contribution.

An "unfunded" deferred compensation plan is any plan not funded in the above sense. With an unfunded plan, an employer may or may not accumulate funds to meet future obligations in some funding vehicle, such as an insurance contract. Nevertheless, the employees have nothing more than the unsecured promise of their employer to pay them at a later date. If the deferred compensation is in fact set aside or invested by the employer, the employees have no legal right to the fund. This definition of "unfunded" has been applied for many years by the Internal Revenue Service in issuing rulings regarding the taxability of benefits payable to participants under deferred compensation plans.<sup>79</sup>

The foregoing definition of "unfunded" has also been applied under ERISA in an unreported decision. In *Butcher & Singer, Inc. v. Johnson*,<sup>80</sup> the court denied cross motions for summary judgment on the question of ERISA coverage. At issue was a deferred compensation plan pursuant to which the employer was accumulating assets in a fund with a brokerage firm. The plan provided that employees had a claim only against the general assets of the corporation and that the fund was subject to the general claims of

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77. *Butcher & Singer, Inc. v. Johnson*, No. 78-3960 (E.D. Pa. July 17, 1979), summarized at [1979-1981 Transfer Binder] PENS. PLAN GUIDE (CCH) ¶ 22,282.

78. The circumstances under which such a forfeiture would occur would be specified in the applicable plan, e.g., an employee's termination before a specified number of years of service or retirement.

79. See Rev. Rul. 72-25, 1972-1 C.B. 127; Rev. Rul. 68-99, 1968-1 C.B. 193. Pursuant to Rev. Proc. 71-19, 1971-1 C.B. 698, the Internal Revenue Service regularly grants advance rulings as to the tax consequences of "unfunded deferred compensation plans." Favorable rulings have been issued on several occasions to plans where insurance has been purchased to help the employer meet its liabilities under the plan but where the insurance policy or contract remains an asset of the employer subject to the claims of general creditors. See, e.g., Priv. Let. Rul. 8134067 (May 27, 1981); Priv. Let. Rul. 8028104 (Apr. 21, 1980).

80. No. 78-3960 (E.D. Pa. July 17, 1979), summarized at [1979-1981 Transfer Binder] PENS. PLAN GUIDE (CCH) ¶ 22,282.

creditors. The employee claimed that this provision was simply included in the plan as a formality for tax purposes and was not really intended. The court held that the question of whether the plan was funded or unfunded depended on whether the employer had the right to use the funds in the ordinary course of its business, a question to be resolved through a trial on the merits.<sup>81</sup>

ERISA fails also to define the term "highly compensated." Presumably, a determination of whether an employee is "highly compensated" will vary from employer to employer depending on the facts and circumstances of the particular case. Some guidance can be found in the Department of Labor advisory opinions, however. In one 1975 opinion, the Department found that the exception applied to a plan for employees earning at least \$18,200 per year who were exempt from the Fair Labor Standards Act as administrative, supervisory, or professional employees.<sup>82</sup> In a second 1975 opinion, a plan was also found exempt where it limited participation to 115 employees who comprised less than 4% of the employer's work force and received average compensation in excess of \$28,000, as compared to a \$19,000 average for all company management employees.<sup>83</sup>

Three more types of deferred compensation arrangements possibly fitting within ERISA's coverage of employee pension benefit plans deserve comment. These are bonus programs, severance pay arrangements, and individual employment agreements providing for deferred compensation.

Labor Department regulations specifically exempt from the pension plan definition bonus payments for work performed "unless such payments are systematically deferred to the termination of covered employment or beyond, so as to provide retirement income to employees."<sup>84</sup> The scope of this exemption was involved in *Murphy v. Inexco Oil Co.*,<sup>85</sup> where the employer paid merit bonuses to employees during employment in the form of fractional interests in mineral properties. The suit was for breach of fiduciary duties. The plaintiff claimed that the plan was a pension plan covered by ERISA since participation in the plan and payments thereunder continued beyond the termination of employment, for

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81. *Id.*

82. Pension & Welfare Benefit Program Op. Let. 75-63, summarized at 4 PENS. PLAN GUIDE (CCH) ¶ 25,136 (1976).

83. Pension & Welfare Benefit Program Op. Let. 75-64, summarized at 4 PENSION PLAN GUIDE (CCH) ¶ 25,136 (1976). I.R.C. § 401(k)(4) (Supp. IV 1980) defines a "highly compensated employee" for purposes of a qualified cash or deferred plan as an employee more highly compensated than two-thirds of the employer's employees.

84. 29 C.F.R. § 2510.3-2(c) (1981).

85. 611 F.2d 570 (5th Cir. 1980).

as long as the mineral interest was producing and generating royalties. The court rejected such reasoning, holding that ERISA coverage depended upon whether the plan was designed for the purpose of paying current compensation or retirement income.<sup>86</sup> A recent advisory opinion makes it far from certain whether the Department of Labor would reach the same conclusion as the court in the *Murphy* case.<sup>87</sup>

Since severance pay continues compensation beyond the termination of employment, a practice of making severance payments to employees technically fits within the definition of a "pension plan" under ERISA.<sup>88</sup> To avoid unneeded regulation of many of such plans, the Department of Labor regulations provide that severance pay plans are not pension plans provided: (1) the payments are not contingent upon the employee's retiring, (2) the total severance payments do not exceed twice the employee's annual compensation, and (3) the payments are terminated generally within a period of twenty-four months after termination.<sup>89</sup>

An individual employment contract requiring a single employee to furnish specific personal services would not normally be a "plan, fund, or program" covered by ERISA even if it provided for payments beyond the termination of employment.<sup>90</sup> Such a contract

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86. The court held with respect to ERISA:

Its words are not to be read as an elastic girdle that can be stretched to cover any content that can conceivably fit within its reach. Any outright conveyance of property to an employee might result in some payment to him after retirement. The words "provides retirement income" patently refer only to plans designed for the purpose of paying retirement income whether as a result of their express terms or surrounding circumstances.

*Id.* at 575 (quoting 29 U.S.C. § 1002(2) (1976)).

87. In Pension & Welfare Benefit Program Op. Let. 80-29A, summarized at [1979-1981 Transfer Binder] PENS. PLAN GUIDE (CCH) ¶ 25,363, the Labor Department gave its opinion with respect to a plan which distributed stock each year to employees. The employees were vested in 20% of the distributed stock each year and, upon separation from service prior to retirement, the shares had to be returned to the company. Since vesting in certain shares did not occur until after retirement, the Department determined that the plan could provide retirement income or result in the deferral of income. Consequently, the plan was a pension plan covered by ERISA.

88. 29 U.S.C. § 1002(2) (1976). See *supra* text accompanying note 45.

89. 29 C.F.R. § 2510.3-2(b) (1981). It should be noted that even though severance pay plans are not pension plans, they do fall within the specific definition of employee welfare benefit plans under 29 U.S.C. § 1002(1) (1976). See *supra* text accompanying note 44. The Department of Labor specifically noted the coverage of severance pay plans as welfare plans in its March 2, 1979 preamble to the regulations. 44 Fed. Reg. 11763 (1979).

90. The definitions of both welfare and pension plans specifically contemplate a program for more than one employee. 29 U.S.C. § 1002(1)-(2) (1976). But cf. 29 C.F.R. § 2510.3-3(b) (1981) (stating that a Keogh plan for a sole proprietor and one common-law employee is a plan covered by ERISA).

was involved in *Jervis v. Elerding*.<sup>91</sup> In that case, the employment agreement required the employer to provide rent-free use of an apartment to an employee after termination of employment. Relying on certain advisory opinions of the Department of Labor, the court held that this post-termination, in-kind compensation was not a "plan, fund, or program."<sup>92</sup> On the other hand, if several individual employment contracts are entered into pursuant to some unified plan or scheme providing deferred compensation, a pension plan subject to ERISA coverage is established.<sup>93</sup>

#### V. *DEPENDAHL V. FALSTAFF BREWING CORP.*

One recent case from the Eighth Circuit concerning the coverage of ERISA deserves special comment. In *Dependahl v. Falstaff Brewing Corp.*,<sup>94</sup> suit was brought by three terminated executives claiming violations of ERISA. The factual background of the suit is as follows. In 1974 Falstaff was in severe financial difficulty and was in need of new capital. It approached an individual, Paul Kalmanovitz, who agreed to invest \$10 million in preferred stock and to guarantee \$10 million of Falstaff debt in exchange for voting control of the corporation. Upon taking control, Kalmanovitz caused the firing of several management employees and took actions to deprive the discharged employees of severance pay and death benefits. In anticipation of the firings, the corporation amended the eligibility requirements of the severance pay plan so as to exclude employees who had not worked for a minimum period of fifteen years. The lower court held that the severance pay plan was an "employee welfare benefit plan" under ERISA and that the employees were entitled to severance benefits.<sup>95</sup> The reason given by the court for ordering the payment of benefits was that, in amending the plan, Falstaff had breached its fiduciary duty to act solely in the interests of participants.<sup>96</sup> It had acted, rather, in its own interests.

There is no question that the severance pay plan was an employee welfare benefit plan under ERISA and that the fiduciaries

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91. 504 F. Supp. 606 (C.D. Cal. 1980).

92. *Id.* at 608.

93. *Dependahl v. Falstaff Brewing Corp.*, 491 F. Supp. 1188, 1195 (E.D. Mo. 1980), *aff'd*, 653 F.2d 1208 (8th Cir.), *cert. denied*, 102 S. Ct. 512 (1981).

94. 653 F.2d 1208 (8th Cir.), *cert. denied*, 102 S. Ct. 512 (1981).

95. 491 F. Supp. at 1196. The lower court had earlier reached this conclusion in a decision on defendant's motion for partial summary judgment. *Calhoun v. Falstaff Brewing Corp.*, 478 F. Supp. 357, 361 (E.D. Mo. 1979).

96. 491 F. Supp. at 1197. 29 U.S.C. § 1104(a) (1976) provides in relevant part: "[A] fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and—(a) for the exclusive purpose of: (i) providing benefits to participants and their beneficiaries . . . ."

with respect to the plan were subject to the fiduciary standards of ERISA. Whether Falstaff was acting as a fiduciary when it amended the plan may be open to some question. The adoption, amendment, and termination of benefit plans seem to be matters where employers properly can and should act in their own interests. The district court seemed to recognize the problem created by its analysis when it made the following somewhat confusing statement: "This decision does not mean that an employer may never cut back on benefits previously provided to employees. This Court merely holds that such a change is not permissible when made expressly in contemplation of actions which would otherwise entitle employees to the previously provided benefits."<sup>97</sup> Seemingly, most employer actions that cut back benefits are in contemplation of events or actions which would entitle employees to benefits. A perhaps better statement of the standard to apply in such cases can be found in the recent First Circuit decision of *Palino v. Casey*.<sup>98</sup> There the joint board of trustees of a Taft-Hartley fund cut back welfare fund benefits and were sued for breach of fiduciary duties under ERISA. The court noted that trustees of funds often modify a fund's terms and operations in light of changing financial conditions and economic considerations. The test formulated by the First Circuit was whether the actions of the trustees were "arbitrary and capricious" or violated standards of "fundamental fairness."<sup>99</sup> Had the court in *Dependahl* used the standard articulated in *Palino*, it would have had a strong factual basis for reaching the same result, and its opinion would have been better reasoned.<sup>100</sup>

Another holding of the lower court in *Dependahl* which was affirmed by the Eighth Circuit regarded Falstaff's termination of the death benefit plan for the fired executives. The court's ruling with respect to that plan highlights some of the effects of the scope of ERISA's Title I coverage. In 1972 Falstaff had adopted a plan for approximately twelve executives which provided for payment of

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97. 491 F. Supp. at 1197.

98. 664 F.2d 854 (1st Cir. 1981).

99. *Id.* at 858-59.

100. The district court found that Kalmanovitz's actions on behalf of Falstaff "were taken maliciously and unjustifiably" and that "[t]hroughout this litigation, Kalmanovitz has shown nothing but contempt for the welfare and rights of plaintiffs, as well as for normal rules of procedure and ethics in this Court." 491 F. Supp. at 1198.

An alternative approach would have been to characterize the plaintiffs' claim as one for plan benefits, rather than a breach of a fiduciary duty, and hold that the severance pay policy contained an implied contractual condition that Falstaff would not terminate the plan when severance was contemplated or had already been decided upon. In either event the court's ultimate decision regarding the payment of severance pay would have been the same.



annuity income benefits to named beneficiaries upon the executive's death. If a participant were terminated for cause, he would forfeit this benefit. Falstaff purchased whole life insurance policies on the lives of each covered executive to fund the benefits. From time to time Falstaff had borrowed on the cash value of the policies to pay the premiums. When Falstaff fired the executives, it determined not to continue the death benefit plan for them. The plaintiff executives requested declaratory and injunctive relief with respect to this plan. The lower court held that the fired executives continued to be covered by the plan, that Falstaff had to continue to hold (and presumably pay premiums on) the whole life insurance contracts, and that no borrowing of cash values would be permitted since such borrowing would constitute a prohibited transaction under ERISA.<sup>101</sup>

The rationale of the district court's holding was either far too broadly stated or based on the incorrect conclusion that the death benefit plan was a "funded" welfare benefit plan with the life insurance policies constituting assets of the plan. The plan clearly was an employee welfare benefit plan under ERISA since it was a plan to provide death benefits.<sup>102</sup> However, on the facts set forth in the opinion, whether it was a "funded" plan is certainly open to considerable question.<sup>103</sup>

The lower court found that section 104(a)(3) of ERISA<sup>104</sup> allowed the Secretary of Labor to exempt certain welfare plans from the reporting and disclosure requirements of the Act. Accordingly, 29 C.F.R. § 2520.104-24<sup>105</sup> provided an exemption for unfunded or insured welfare plans for a select group of management or highly compensated employees. Finding the death benefit plan within the exemption, the lower court concluded: "The fact that the CBS Plan is exempted from this part of ERISA necessarily implies that it is otherwise included within the Act's coverage."<sup>106</sup> This finding overlooks the fact that section 201(a)(1) of the Act<sup>107</sup> specifically exempts welfare plans from participation and vesting requirements, and that section 301(a)(1) of the Act<sup>108</sup> specifically exempts welfare plans from the funding requirements.

Relying on the same regulation, the lower court then concluded "unfunded" meant that benefits were to be paid from the com-

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101. *Id.* at 1195-96.

102. 29 U.S.C. § 1002(1) (1976). *See supra* text accompanying note 44.

103. *See supra* text accompanying notes 75-81.

104. 29 U.S.C. § 1024(a)(3) (1976).

105. 29 C.F.R. § 2520.104-24 (1981).

106. 491 F. Supp. at 1195.

107. 29 U.S.C. § 1051 (1976).

108. *Id.* § 1081.

pany's general assets.<sup>109</sup> Since "Falstaff has allowed the insurance companies to accumulate a fund for the eventual payment of benefits," the court reasoned, benefits could not be paid from general assets and thus the plan was "funded."<sup>110</sup>

The Eighth Circuit took that rationale a step further and held:

We agree with the district court's conclusion that the plan was funded. Funding implies the existence of a *res* separate from the ordinary assets of the corporation. *All whole-life insurance policies which have a cash value with premiums paid in part by corporate contributions to an insurance firm are funded plans.* The employee may look to a *res* separate from the corporation in the event the contingency occurs which triggers the liability of the plan.<sup>111</sup>

If such a holding were correct, the use of insurance as a funding vehicle for fringe benefit plans and deferred compensation plans for the highly compensated would lose all of its attraction. The adverse tax effects on participants in such plans would be substantial.<sup>112</sup> As discussed previously,<sup>113</sup> however, whether an employee benefit plan is funded depends upon whether the assets are irrevocably contributed by the employer to a separate fund, e.g., a trust, a group annuity contract, or an escrow account. On the other hand, if the assets of the plan, life insurance contracts or otherwise, are subject to the claims of general creditors, the plan is unfunded.<sup>114</sup> The rationale of the decision in *Dependahl* was clearly too broadly stated and probably incorrect.

A recent advisory opinion issued by the Department of Labor indicates little inclination on the part of the government to follow the decision in *Dependahl* regarding the interpretation of a "funded" plan.<sup>115</sup> In the advisory opinion, the Department found that life insurance policies which constituted a vehicle to accumulate assets for a death benefit plan were not assets of the plan. The terms of the plan carefully explained that employees had no direct interest in the life insurance policies. The opinion explained the plan provisions as follows:

The insurance proceeds would be payable only to the corporation, which would be named as beneficiary. The corporation would have all rights of ownership under the policies, which would be subject to the claims of the corporation's creditors. Neither the plan nor any participant or beneficiary would have any preferred claim against the policies or any beneficial ownership interest in the policies. There would be no representation to any participant or beneficiary that the policies will be used only to provide

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109. 491 F. Supp. at 1195.

110. *Id.*

111. 653 F.2d at 1214 (emphasis added).

112. See *supra* text accompanying note 74.

113. See *supra* text accompanying notes 75-81.

114. See *id.*

115. Pension & Welfare Benefit Program Op. Let. 81-11A, 4 PENS. & PROFIT SHARING (P-H) ¶ 120,146 (1981).

plan benefits and the plan benefits would not be limited or governed in any way by the amount of the insurance proceeds received by the corporation.<sup>116</sup>

Of course, if the life insurance policies do not constitute plan assets, no fiduciary duties are owed with respect to holding the policies, and clearly they can be cancelled, transferred, or borrowed against without regard to the prohibited transaction rules of ERISA.<sup>117</sup> Nevertheless, in view of the confusing decision by the Eighth Circuit in *Dependahl*, practitioners would be prudent to incorporate the quoted provisions of the advisory opinion in both unfunded welfare and pension benefit plans where life insurance is used to cover potential liabilities.

## VI. CONCLUSION

As more court decisions, regulations, rulings, and advisory opinions are issued on the subject, the breadth of ERISA's coverage and the impact such coverage can have on the rights and remedies of employers and employees is becoming more and more apparent. In drafting plans of all types, practitioners must be aware of the expansive scope of ERISA's coverage and the potential pitfalls, new liabilities, and new responsibilities imposed by that coverage.

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116. *Id.*

117. 29 U.S.C. § 1106 (1976).