

Symposium Note

Retiree Health Benefits: The Promise of a Lifetime?

There were promises made across this desk!
You mustn't tell me you've got people to see —
I put 34 years into this firm . . . and now I
can't pay my insurance? You can't eat the orange
and throw the peel away — a man is not a piece
of fruit!

Willy Loman in Arthur Miller's
Death of a Salesman

I. THE FACTUAL SETTING

The alarming increase in health care costs concerns most Americans.¹ Of particular concern is the cost of providing health care once a person retires. Medicare, enacted in 1966, was expected to cover the health care needs of those over sixty-five years of age.² However, as the gap increased between actual health care costs and Medicare coverage, many employers agreed to provide supplemental health insurance for their retirees.³ While employers are not required by law to provide these benefits,⁴ many employers offer them as an incentive to attract and retain good employees.⁵

Most companies do not prefund these benefit plans but instead operate on a "pay-as-you-go" system.⁶ In the past this strategy has worked well since the costs of the programs were relatively small. However, a number of factors including high medical care inflation,⁷ a general aging in the population,⁸ in-

1. The cost of health care accounts for approximately 11% of the GNP. The U.S. Bureau of Labor Statistics estimates that physician's fees have increased over 262% since 1967 and the cost of hospital stays, *i.e.*, room and board, has increased more than 824% since 1965. See Hosay, *Recent Efforts to Control Health Care Costs*, 1985 PROC. OF N.Y.U. 38TH ANN. NAT'L CONF. ON LAB. 3-1, 3-2.

2. Jones, *Staying Afloat: Public Employer Retiree Health Plans*, EMPLOYEE BENEFIT PLAN REV., July, 1989 at 52.

3. Ninety-four percent of those companies employing 10,000 or more workers offer retiree health care benefits, and 42% of companies with less than 100 employees have retiree health plans. Most employers pay the entire cost of the plans, which usually cover hospitalization and a portion of prescriptions and doctors' fees. Bennett, *Firms Stunned By Retiree Health Costs*, Wall St. J., May 24, 1988, at 41, col. 3.

4. 29 U.S.C. § 1003(a) (1988).

5. Van Olson, *Nonpension Retiree Benefits: Are They for Life? Management Guidelines to the Issue*, 36 LAB. L.J. 402, 408 (1985).

6. In a recent survey, 84% of the employers polled indicated that they funded health care benefits for retirees on a "pay-as-you-go" basis. Burcke, *Few Employers Determine Cost of Retiree Care*, Bus. Ins., Feb. 13, 1989, at 1, col. 1.

7. See *supra* note 1 and accompanying text.

8. The population over age 60 will increase rapidly in the near future. In 1980 the median age of the population was 30. By the year 2050 the median age is expected to increase to 42. *Demographics May Dictate Retirement Policy Changes*, EMPLOYEE BENEFIT PLAN REV., Dec., 1988 at 58.

creased life expectancy,⁹ the trend toward early retirement,¹⁰ and the federal government's reduction of Medicare coverage¹¹ has resulted in a dire situation for employers as well as retirees. Recent studies estimate the aggregate accrued liability of retiree health care benefits at \$200 billion.¹² When this is coupled with the \$700 billion in pension debt which corporations owe employees, employee debt is the largest corporate debt category in America.¹³ In comparison, corporations owe about \$500 billion each to bond holders and banks.¹⁴

The impact of the massive retiree health care debt will be felt in 1992 when the Financial Accounting Standards Board (FASB) will implement a new accounting rule requiring companies to include the present value of future health care obligations as a liability on their balance sheets.¹⁵ In accounting terminology, the new rule mandates accrual basis accounting rather than the cash basis (*i.e.*, "pay-as-you-go") method currently used by most companies.¹⁶

In financial terminology the new rule means less profits. The nation's corporations could experience a twenty-five to fifty percent decrease in profits once these liabilities are figured into the balance sheets.¹⁷ Companies are, understandably, concerned about the effects of the new ruling. As one commentator noted, a \$100 million clean up order from the Environmental Protection Agency can alone bankrupt many small companies, and the new FASB rule has the potential of being equally devastating.¹⁸ The potential for serious problems and possibly financial ruin is present in the unfunded retiree liability situation.

Many companies, in an attempt to avoid financial problems resulting from retiree health care liabilities, have restructured health care benefits. In many cases the employers have totally cut or reduced health care benefits for their retired employees,¹⁹ thus leaving many retirees and/or their dependents in desperate straits. Retirees, especially those under the age of sixty-five, and thus not covered by Medicare, may suffer severe financial hardships when health care benefits are suddenly terminated or altered.²⁰ A serious illness can financially

9. In 1980 the U.S. Census Bureau estimated that the average life expectancy at 65 was 15.5 years. In 1990 the Bureau projects that a 65-year-old can expect to live 16.8 more years. *Id.*

10. The Department of Labor found that in 1970 49% of 65-year-old men were in the work force as compared to 1986 when only 30.8% of 65-year-old men were still employed. *Id.* It is estimated that by 1996 for every two workers on payroll, an employer will be providing health care benefits for one retiree. Adler, *Retiree Health Care Costs Staggering*, Bus. Ins., June 6, 1988, at 10, col. 1.

11. Jones, *supra* note 2, at 52-53.

12. This estimate is based on studies by the U.S. Government General Accounting Office and the Employee Benefits Research Institute. Standard actuarial techniques were used which took into account reasonable health care cost projections and investment discount rates. Ambachtsheer, *Employee Benefits as Corporate Debt: What Investment Professionals Should Know*, FIN. ANALYSTS J., Mar.-Apr. 1989, at 5.

13. *Id.*

14. *Id.*

15. In figuring future health care liabilities, companies must take into account all existing retirees plus any active employees who are eligible for retirement. Total liability will not be figured in the first year, but will be phased-in gradually over a number of years. Burcke, *supra* note 6, at 28, col. 1. *See also* Bennett, *supra* note 3.

16. *See supra* note 6.

17. Bennett, *supra* note 3, at 41, col. 4.

18. Adler, *supra* note 10, at 10, col. 1, 3.

19. Thirty-nine percent of employers offering retiree health care plans have changed coverage in the last two years. Burcke, *supra* note 6, at 28, col. 5.

20. *See, e.g.*, Note, *Employee Benefits Law: Securing Employee Welfare Benefits Through ERISA*, 61 NOTRE DAME L. REV. 551, 552 n.10 (1986).

devastate a retiree in this situation.²¹ Furthermore, a retiree, by virtue of being retired, has no bargaining power with an employer, thus leaving litigation as the only remedy.²² In fact, many cases have been litigated on the issue of employer reduction/termination of retiree health care benefit plans.²³

The purpose of this Note is to present an understandable discussion of the statutes and legislative history applicable to this area of litigation as well as the case law and legal theories which have developed. As will be shown, the results are often dissatisfying and continue to leave both employers and employees in uncertain positions. To this end, I shall propose suggestions to remedy the problems faced in the area of retiree health benefits.

II. THE LEGAL BACKGROUND—ERISA, CONGRESSIONAL INTENT, AND FEDERAL COMMON LAW

Employee retirement benefits are governed by both statute and a specialized area of federal common law.²⁴ The Employee Retirement Income Security Act of 1974 (ERISA)²⁵ was promulgated by Congress "to promote the interests of employees and their beneficiaries in employee benefit plans."²⁶ Employers are not required to provide benefits plans,²⁷ but once plans are provided they must comply with ERISA regulations.²⁸ ERISA governs two types of benefit plans: (1) pension plans, and (2) welfare benefit plans²⁹ (which include retiree insurance benefits, the topic of this Note³⁰). Pension plans provide retirement income to retirees, usually in the form of deferred income,³¹ and are comprehensively regulated by ERISA. For example, an employer must prefund pension plans.³² However, employer contributions to the plan are tax deductible.³³ Additionally, ERISA provides vesting requirements for pension plans, which means that upon fulfillment of the statutory conditions, such as meeting certain age and service requirements, the employee has a legal and nonforfeitable right to the benefits.³⁴

Welfare benefits, on the other hand, are not so completely regulated by ERISA. In contrast to pension benefits, welfare benefits have no funding requirements³⁵ nor are there any tax breaks for doing so.³⁶ Most important to this

21. *Id.*

22. See *Reducing Retirees' Health Benefits: The Courts Develop a Remedy*, 18 CLEARINGHOUSE REV. 1399 (1985).

23. See *infra* notes 71-168 and accompanying text.

24. See generally Van Olson, *supra* note 5, at 402-03.

25. Employee Retirement Income Security Act of 1974, 29 U.S.C.

§§ 1001-461 (1988).

26. *Shaw v. Delta Airlines, Inc.*, 463 U.S. 85, 90 (1983). See also 29 U.S.C. § 1001(b).

27. 29 U.S.C. § 1003.

28. 29 U.S.C. § 1003(a).

29. 29 U.S.C. § 1002(1)(B).

30. Welfare benefit plans are defined as any plan which provides, among other things, medical, surgical, hospital, sickness, accident, disability, or death benefits. 29 U.S.C. § 1002(1)(A).

31. 29 U.S.C. § 1002(2).

32. 29 U.S.C. § 1082.

33. I.R.C. §§ 401, 404 (1988).

34. 29 U.S.C. §§ 1051-61.

35. I.R.C. § 401.

36. *Id.*

Note, welfare benefits are exempted from the vesting requirements of pension plans.³⁷ The exemption of welfare benefit plans from the minimum vesting requirements leaves both employers and employees in uncertain positions. The statute does not state whether welfare benefit plans ever vest, nor does it specifically allow for employers to change or terminate welfare benefit plans.³⁸

Furthermore, neither state common law nor state statutory law may be used to fill in the gaps where ERISA is silent.³⁹ ERISA specifically preempts all state laws insofar as they relate to any employee benefit plan regulated by ERISA.⁴⁰ The Supreme Court has made it clear that the preemption language of ERISA must be construed broadly. In *Shaw v. Delta Airlines* the Court rejected the view that states could regulate those areas in which ERISA was silent.⁴¹ In a later case, *Metropolitan Life Insurance Co. v. Massachusetts*, the Court went further in holding that "[t]he pre-emption provision was intended to displace all state laws that fall within its sphere, even including state laws that are consistent with ERISA's substantive requirements."⁴²

Many courts and commentators believe that Congress intended the gaps in ERISA to be filled by a common law developed by the federal courts.⁴³ Although the federal courts do not have the power to promulgate a body of common law,⁴⁴ they do have the power to interpret laws enacted by Congress.⁴⁵ This power includes the authority to develop rules where Congress has not spoken.⁴⁶ However, in order to exercise this authority, the courts must be certain that Congress purposely left a void to be filled by the courts.⁴⁷ Congressional intent is often sought in a statute's legislative history. There are several items of legislative history which courts cite in supporting congressional intent for federal courts to develop judicial ERISA law.⁴⁸ These items of legislative history include statements made by the proponents of ERISA when presenting it to the Senate.⁴⁹

The presentation to the Senate of the House Conference Report of the Committee on Pension Benefit Reform⁵⁰ is relied upon most heavily in support-

37. 29 U.S.C. § 1051(1).

38. See Van Olson, *supra* note 5, at 403.

39. Prior to the enactment of ERISA, regulation of employee benefit plans were, for the most part, left to the realm of state law. See Ray, *The Russell Case: Retreat in the Development of ERISA Common Law?* 1986 Proc. OF N.Y.U. 39TH ANN. NAT'L CONF. ON LAB. 5-1, 5-11.

40. 29 U.S.C. § 1144(a).

41. 463 U.S. 85, 98 (1983).

42. 471 U.S. 724, 739 (1985).

43. See *infra* text accompanying notes 48-59.

44. *City of Milwaukee v. Ill.*, 451 U.S. 304, 312-14 (1981); *Northwest Airlines v. Trans. Workers*, 451 U.S. 77, 95-96 (1981). See generally Merrill, *The Common Law Powers of Federal Courts*, 52 U. CHI. L. REV. 1 (1985).

45. *Milwaukee v. Ill.*, 451 U.S. at 314.

46. *Id.*

47. *Id.* at 313-14.

48. See Note, *supra* note 20, at 556.

49. *Id.*

50. JOINT EXPLANATORY STATEMENT OF THE COMMITTEE OF CONFERENCE, H.R. REP. NO. 1280, 93d Cong., 2d Sess. 327 (1974), reprinted in 1974 U.S. CODE CONG. & ADMIN. NEWS 5038, and in 3 LEGISLATIVE HISTORY OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974, at 4277 (1976).

ing the courts' ERISA common law power.⁵¹ Senator Javits, ranking minority member of the Senate Committee on Labor and Public Welfare and a primary sponsor of ERISA, said during the presentation of ERISA, "[i]t is also 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."⁵²

Another statement frequently cited by the courts is that of Senator Williams, the Labor and Public Welfare Committee Chairman and another main proponent of ERISA.⁵³ Williams stated that suits arising under ERISA "will 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."⁵⁴

In *Textile Workers v. Lincoln Mills* the Supreme Court established the well-accepted principle that Section 301 of the Labor Management Relations Act (*i.e.*, Taft-Hartley Act) gave federal courts the authority to fill in statutory gaps by formulating common law congruent with the policies set forth by Congress.⁵⁵ In *Lincoln Mills* the Court stated:

We conclude that the substantive law to apply in suits under § 301(a) is federal law, which the courts must fashion from the policy of our national labor laws. The Labor Management Relations Act expressly furnishes some substantive law. It points out what the parties may or may not do in certain situations. Other problems will lie in the penumbra of express statutory mandates. Some will lack express statutory sanction but will be solved by looking at the policy of the legislation and fashioning a remedy that will effectuate that policy. The range of judicial inventiveness will be determined by the nature of the problem. (citations omitted)⁵⁶

The courts, as a result of this case, have created a large body of substantive law in the area of labor relations.⁵⁷ Senator Williams' statement suggests that Congress intended for the federal courts to treat ERISA in the same manner as the Taft-Hartley Act. The lower federal courts have embraced this idea since shortly after ERISA was enacted.⁵⁸ Additionally, the Supreme Court has recognized the federal courts' role in developing a body of common law to supplement ERISA.⁵⁹

Therefore, in the situation in which ERISA is silent as to the vesting, modification, and termination of employee welfare benefits, the federal courts have recognized causes of action upon which employees may base claims. Additionally, the courts have used federal common law to guide their decisions in these cases.

51. See Note, *supra* note 20, at 557.

52. See *Mass. Mut. Life Ins. Co. v. Russell*, 473 U.S. 134, 156 (1985) (Brennan, J., concurring) (citing 120 CONG. REC. 22, 29942 (1974), reprinted in 3 LEGISLATIVE HISTORY OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974, at 4771 (1976)).

53. *Id.* (citing 120 CONG. REC. 22, 29933 (1974), reprinted in 3 LEGISLATIVE HISTORY OF THE EMPLOYEE RETIREMENT SECURITY ACT OF 1974, at 4745 (1976)).

54. *Id.*

55. 353 U.S. 448 (1957).

56. *Id.* at 456-57.

57. See Ray, *supra* note 39, at 5-11 n.20.

58. *Id.* at 5-3 n.7.

59. *Pilot Life Ins. Co. v. Dedeaux*, 481 U.S. 56 (1987); *Franchise Tax Bd. v. Constr. Laborers Vacation Trust*, 463 U.S. 1 (1983).

Basically, three theories have been proposed in suits involving the modification or termination of a retirement welfare benefit: (1) fiduciary duty, (2) status benefit, and (3) contract. The next section of this Note will explain and discuss each of these theories.

III. LEGAL THEORIES

A. *Fiduciary Duties*

1. *The Concept of a Fiduciary Under ERISA*

One theory used by employees in bringing suit against employers for reducing or terminating welfare benefits is that the employers have breached fiduciary duties owed under ERISA. Employers establishing an employee benefit plan are governed by ERISA,⁶⁰ which requires the naming of a fiduciary who "shall have authority to control and manage the operation and administration of the plan."⁶¹ Frequently the employer will name itself as the fiduciary. However, the employer may also be constructively deemed the fiduciary although it did not explicitly appoint itself as such. ERISA defines a fiduciary as a person who exercises any discretionary authority or control regarding the management or disposition of plan assets,⁶² and courts have held that the term "fiduciary" under ERISA must be construed broadly.⁶³ Further, Congress has stated that persons will be deemed fiduciaries if they "have authority and responsibility with respect to the matter in question, regardless of their formal title."⁶⁴ Therefore, a corporation is a fiduciary to the extent that it exercises any discretionary management or control over an employee benefits plan.⁶⁵

Once one is deemed a fiduciary, very strict duties are imposed by ERISA. In pertinent part, ERISA defines those duties by stating:

[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; . . .

. . . .

(B) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.⁶⁶

60. See *supra* notes 27-28 and accompanying text.

61. 29 U.S.C. § 1102(a)(1) (1988).

62. 29 U.S.C. § 1002(21)(A).

63. *Donovan v. Mercer*, 747 F.2d 304, 308 (5th Cir. 1984).

64. JOINT EXPLANATION STATEMENT OF THE COMMITTEE OF CONFERENCE, H.R. REP. NO. 1280, 93d Cong., 2d Sess. 323 (1974), reprinted in 1974 U.S. CODE CONG. & ADMIN. NEWS 5038, 5103, and in 3 LEGISLATIVE HISTORY OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974, at 4277, 4590 (1976).

65. *Miniat, Inc. v. Globe Life Ins. Group, Inc.*, 805 F.2d 732, 735-36 (7th Cir. 1986), cert. denied, 482 U.S. 915 (1987); *Sommers Drug Stores v. Corrigan Enter., Inc.*, 793 F.2d 1456, 1460 (5th Cir. 1986), cert. denied, 479 U.S. 1034 (1987); *Amato v. Western Union Int'l, Inc.*, 773 F.2d 1402, 1417 (2d Cir. 1985) cert. dismissed, 474 U.S. 1113 (1986); *Leigh v. Engle*, 727 F.2d 113, 133 (7th Cir. 1984); *Monson v. Century Mfg. Co.*, 739 F.2d 1293, 1303 (8th Cir. 1984); *Eaves v. Penn*, 587 F.2d 453, 458 (10th Cir. 1978).

66. 29 U.S.C. § 1104(a)(1) (1988).

Furthermore, ERISA imposes liability for a breach of fiduciary duty⁶⁷ and specifically prohibits certain transactions.⁶⁸ For example, a fiduciary shall not, in any transaction involving the plan, act on behalf of a party whose interests are adverse to those of the plan or its beneficiaries.⁶⁹ Any alleged breach by a fiduciary may be sued upon under provisions of ERISA which allow a beneficiary to bring a civil action.⁷⁰

2. *Application of the ERISA Fiduciary Duty in Cases Involving the Modification of Welfare Benefit Plans*

Given the courts' liberality in constructively deeming employers fiduciaries⁷¹ and the very strict duties imposed on fiduciaries to act in the interests of plan beneficiaries,⁷² it would seem that employees would be successful in suits where the employer has modified the terms of the welfare benefit plan to the detriment of the beneficiaries. Surprisingly, however, employees have usually failed under this theory. The failure is due to the courts' differentiation between the employer in its role as a plan fiduciary and in its role as an employer. This differentiation is frequently explained as the "two hat analysis."

In the case of *Amato v. Western Union International, Inc.*⁷³ the court held that ERISA allows an employer who is also a plan administrator to wear "two hats," and an employer is bound by the fiduciary duties of ERISA only when and to the extent the employer is functioning in its capacity as plan administrator. When the employer takes off the plan administrator hat and dons its employer hat, it is not bound by ERISA.⁷⁴ The court further held that modifying the terms of employee benefit plans is an "employer" function.⁷⁵ Therefore, since the employer is not wearing its plan administrator hat in taking this action, the fiduciary duties do not attach, and thus there can be no breach of duty.

Many cases have followed the *Amato* analysis and distinguish the administration and management of a plan in accordance with its terms from setting the terms of the plan.⁷⁶ The rationale for this distinction is that ERISA does not require an employer to establish an employee benefit plan, but rather governs a plan once it is established.⁷⁷ Therefore, an employer who decides to provide a benefit plan should not be denied the right to change the plan when there are

67. 29 U.S.C. § 1105.

68. 29 U.S.C. § 1106.

69. 29 U.S.C. § 1106(b)(2).

70. 29 U.S.C. § 1132.

71. See *supra* notes 62-65 and accompanying text.

72. See *supra* notes 66-69 and accompanying text.

73. 773 F.2d 1402 (2d Cir. 1985), *cert. dismissed*, 474 U.S. 1113 (1986).

74. *Id.* at 1416-17.

75. *Id.*

76. See, e.g., *Mutso v. American General Corp.*, 861 F.2d 897, 911-12 (6th Cir. 1988), *cert. denied*, 109 S.Ct. 1745 (1989); *U.A.W. v. Park-Ohio Indus., Inc.*, 661 F. Supp. 1281, 1300-01 (N.D. Ohio 1987). See also *Moore v. Reynolds Metals Co. Retirement Program*, 740 F.2d 454, 456 (6th Cir. 1984); *Sutton v. Weirton Steel Div.*, 724 F.2d 406, 411 (4th Cir. 1983), *cert. denied*, 467 U.S. 1205 (1984) (both cases differentiate between administration and setting the terms of a plan in the area of pension benefits).

77. See *supra* notes 27-28 and accompanying text.

employers who provided no benefit plans at all.⁷⁸ As Judge Celebrezze stated in *Moore v. Reynolds Metals Co. Retirement Program*:⁷⁹

Neither Congress nor the courts are involved in either the decision to establish a plan or in the decision concerning which benefits a plan should provide. In particular, courts have no authority to decide which benefits employers must confer upon their employees; these are decisions which are more appropriately influenced by forces in the marketplace, and, when appropriate, by federal legislation.⁸⁰

Although *Moore v. Reynolds Metals* involved a pension plan rather than an employee welfare benefit plan, the argument that employers should have free reign in modifying plans since they are under no obligation to provide them is equally applicable to the welfare benefit situation.⁸¹ In fact, the argument may be even stronger since ERISA specifically exempts welfare plans from the statutory vesting of pension plans.⁸² Furthermore, evidence suggests that Congress was concerned that employers would be deterred from establishing plans if vesting requirements were too comprehensive. Vesting would lock employers into providing the benefits, and the cost of such a program could put too much of a financial burden on employers.⁸³ Therefore, perhaps the courts accepting the "two hat analysis" have correctly applied Congress' intent to maintain flexibility in the provision and modification of welfare benefit plans.

However, adopting the rationale that employers are free to change the terms of the welfare benefit plans leads to a rather bizarre result when coupled with the fiduciary duty language of ERISA. Presumably, an employer has more freedom in changing the language of a benefit plan than in construing the language of the plan.⁸⁴ According to *Amato*, an employer may change a welfare benefit plan without fiduciary duties of ERISA attaching. However, if an employer is acting as an administrator of the plan, fiduciary duties attach and the employer must act in the best interest of the plan's beneficiaries.⁸⁵ Carrying these propositions to their logical ends, the fiduciary duty imposed by ERISA is made illusory in this type of situation. An employer wearing the fiduciary hat who does not want to provide benefits as provided by the plan need only replace the fiduciary hat with the employer hat and change the plan's language.⁸⁶

78. *Sutton v. Weirton Steel Div.*, 724 F.2d at 411.

79. 740 F.2d 454 (6th Cir. 1984).

80. *Id.* at 456.

81. *Id.*

82. 29 U.S.C. § 1051 (1988).

83. S. REP. NO. 383, 93d Cong., 2d Sess. 18 (1974), reprinted in 1974 U.S. CODE CONG. & ADMIN. NEWS 4890, 4904, and in 1 LEGISLATIVE HISTORY OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974, at 1063, 1086 (1976).

84. See *Baker v. Lukens Steel Co.*, 793 F.2d 509 (3d Cir. 1986).

85. See *supra* text accompanying notes 73-75.

86. This presumably only applies to at-will employees since in the case of a union employee, a welfare benefit plan would be part of the collective bargaining agreement and, therefore, would have the force of a contractual provision. The result seems unfair to non-union employees who have worked at the company in reliance upon the welfare benefits.

3. *The Standard of Review of Fiduciaries Construing Welfare Benefit Plan Language*

Some cases have been litigated in which it was presumed that the employer was wearing its plan administrator hat and allegedly breached its fiduciary duty by construing the terms of the plan so as to deny employees welfare benefits. Employees have been generally unsuccessful in these cases since, until recently, courts have applied an "arbitrary and capricious" standard of review to the decisions of the plan administrators/employers. The result of this standard is to give a great deal of deference to plan administrators while imposing a very heavy burden of proof on the plaintiff.⁸⁷ The arbitrary and capricious standard of review has its origins in trust law. A well-established principle of trust law gives a trustee broad discretion in distributing the assets of a trust unless there is explicit language limiting the trustee's discretion.⁸⁸ Therefore, "[w]here discretion is conferred upon the trustee with respect to the exercise of a power, its exercise is not subject to control by the court, except to prevent an abuse by the trustee of his discretion."⁸⁹ Thus, a great deal of deference is afforded trustees by the courts. However, one exception to this deference is when "the trustee has an interest conflicting with that of the beneficiary."⁹⁰ In this situation courts will place a greater check on the trustee's exercise of discretion.⁹¹

The arbitrary and capricious standard of review for ERISA cases did not derive directly from these common law principles of trust, but instead came through the intermediary of the Labor Management Relations Act (LMRA).⁹² The Labor Management Relations Act provides for the establishment of pension plans for union employees with such plans to be administered by a board in which employers and employees are equally represented.⁹³ Because the conflicts of interest are equalized due to the makeup of the trustees, courts, in accordance with principles of trust law, granted LMRA pension plan trustees a great deal of deference.⁹⁴ The case of *Kennet v. United Mineworkers of America*⁹⁵ established the standard of review in LMRA cases as "whether the action of the trustees is in any way arbitrary or capricious."⁹⁶ Thereafter the arbitrary and capricious standard became well-accepted in reviewing the actions of LMRA pension plan administrators.⁹⁷

Because courts frequently draw on LMRA principles when dealing with analogous situations under ERISA,⁹⁸ it was natural that courts should automat-

87. See generally Page, *Retiree Insurance Benefits: Enforcing Employer Obligations*, 1987 LAB. L.J. 496, 501.

88. RESTATEMENT (SECOND) OF TRUSTS § 187 (1959).

89. *Id.*

90. *Id.* comment g.

91. *Id.*

92. *Bruch v. Firestone Tire & Rubber Co.*, 828 F.2d 134, 140-41 (3d Cir. 1987), *aff'd in relevant part*, 489 U.S. 101 (1989).

93. *Id.* at 141.

94. *Id.* at 141-43.

95. 183 F. Supp. 315 (D.D.C. 1960).

96. *Id.* at 318.

97. See *Bruch*, 828 F.2d at 143.

98. See *supra* text accompanying notes 54-59.

ically adopt the arbitrary and capricious standard when reviewing fiduciary duties of plan administrators under ERISA.⁹⁹ Numerous cases have been decided using the arbitrary and capricious standard in benefit plans regulated by ERISA.¹⁰⁰

However, a few federal circuit courts, and most recently the United States Supreme Court,¹⁰¹ have expressed dissatisfaction with the application of the arbitrary and capricious standard to ERISA cases. Many of the lower federal courts have expressed discontent with the arbitrary and capricious standard of review.¹⁰² The court in *Struble v. New Jersey Employees' Welfare Trust Fund*¹⁰³ justified not applying the arbitrary and capricious standard based on the type of challenge that was made to fiduciary loyalty.¹⁰⁴ The situation in *Struble* involved a collective bargaining agreement between union and employer in which the employer was to contribute a set dollar amount per employee into a retiree welfare benefit plan.¹⁰⁵ However, the trust fund became overfunded in that the employer contributed more money to the fund than it would cost to provide the amount of benefits promised under the welfare benefit plan. The trustees refunded the excess money to the employer on the theory that the employers were only required to fund a certain level of benefits, and having met that obligation, were entitled to the excess. The employees sued, alleging that the trustees had breached their fiduciary duties because the employers were contractually obligated to contribute a set amount per employee, and any resulting overfunding should be used to increase the level of benefits under the welfare plan.¹⁰⁶

In this case, a per se conflict of interest problem was not present as the fiduciaries were half union representatives and half employer representatives.¹⁰⁷ Therefore, this factor was not the rationale for the court refusing to apply the arbitrary and capricious standard.¹⁰⁸ Rather, the court made a distinction between claims in which the trustees are balancing the individual's claim against the interest of future claimants, and, as in this situation, where the trustees have advanced the interests of non-beneficiaries.¹⁰⁹

The court found the arbitrary and capricious standard appropriate in the situation involving an individual claimant. In such a situation the trustees are balancing the interests of the individual beneficiaries against all of the other beneficiaries who may later have a claim. This is different from the case here where "the trustees have sacrificed the interests of the beneficiaries as a class in

99. See *Bruch*, 828 F.2d at 143 (citing the first cases to apply the LMRA standard to ERISA).

100. *Id.* at 138.

101. *Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101 (1989).

102. See *Bruch*, 828 F.2d at 139.

103. 732 F.2d 325 (3d Cir. 1984).

104. *Id.* at 333.

105. *Id.* at 329.

106. *Id.*

107. *Id.*

108. See *infra* notes 112-18 and accompanying text.

109. *Struble*, 732 F.2d at 333-34.

favor of some third party's interests."¹¹⁰ Therefore, the court held the appropriate standard to be the prudent man standard of ERISA.¹¹¹

Other courts have based dissatisfaction with the arbitrary and capricious standard on the fact that, unlike LMRA cases, the ERISA plan administrator is frequently the employer and, therefore, operates under a conflict of interest. Common law trust principles dictate against broad discretion to a trustee whose own interests may conflict with the interests of beneficiaries.¹¹²

*Bruch v. Firestone Tire & Rubber Co.*¹¹³ is one case involving a trustee conflict of interest. In *Bruch*, Firestone was both the employer and the plan administrator of certain welfare benefit plans.¹¹⁴ Firestone sold one of its subsidiaries and the plaintiffs, employees of the subsidiary, attempted to collect welfare benefits from Firestone. Firestone refused to award the requested benefits based on its construction of the plans' terms.¹¹⁵ Plaintiffs brought suit alleging that Firestone had breached its fiduciary duty as a plan administrator. The district court, applying the arbitrary and capricious standard of review, held for Firestone. Under the deferential standard, the court did not believe it could reverse the administrator's construction of the plan's language.¹¹⁶

On appeal to the Third Circuit, the plaintiffs urged against application of the arbitrary standard, arguing that "both the common law of trusts and federal common law developed pursuant to ERISA counsel against deferring to decisions by fiduciaries with interests adverse to those of the claimants."¹¹⁷ The court recognized at least two instances when a conflict can occur:

[A] conflict can occur, for example, if the employer is the plan administrator and the plan provides that the employer's contributions in a given year are determined by the cost of satisfying plan liabilities in the prior year. Or, as in this case . . . a conflict of interest may occur if the plan administrator is also the employer and the plan is unfunded, so that any benefits provided by the plan are paid directly by the employer out of its general corporate funds.¹¹⁸

The court refused to apply the arbitrary and capricious standard, basing its opinion in part on the conflict of interest present in this case.¹¹⁹

The court acknowledged that a frequently cited rationale for the arbitrary and capricious standard is that a plan administrator has more expertise than a judge in managing and determining the meaning of a plan's terms.¹²⁰ The court, while admitting that trustees were better able to make some decisions (such as investing plan funds), refused to give them across the board deference. Courts are better suited to make certain other decisions, such as when "the validity of

110. *Id.* at 333.

111. *Id.* at 332-33. *See supra* note 66 and accompanying text.

112. *See supra* note 90 and accompanying text.

113. 828 F.2d 134 (3d Cir. 1987), *aff'd in relevant part*, 489 U.S. 101 (1989).

114. *Bruch*, 828 F.2d at 136.

115. *Id.* at 137.

116. *Id.*

117. *Id.*

118. *Id.* at 137-38.

119. *Id.* at 144.

120. *Id.*

the claim is likely to turn on a question of law or of contract interpretation."¹²¹ Courts are especially in a better position to make these decisions when the administrator has a conflict of interest.¹²² In this case the court applied a de novo standard of review in that it rendered the decision by interpreting the language of the contract. The court applied pure contract principles and gave no special deference to either party.¹²³

Bruch was appealed to the Supreme Court,¹²⁴ which resulted in the Court establishing a blanket rule that all actions brought under ERISA which challenge denials of benefits based on plan interpretation will be reviewed using a de novo standard.¹²⁵ The Court, recognizing that ERISA established no standard on which courts are to review fiduciary duties,¹²⁶ found the authority to establish a standard based on the principle that courts are to promulgate a body of federal common law where ERISA is silent.¹²⁷

Although the Court affirmed the de novo standard of the lower court, it did so on a different rationale. While the lower court based its decision on the concern of an impartial plan administrator, the Supreme Court found the basis for a de novo standard in trust law.¹²⁸ The Court, citing trust commentators and cases,¹²⁹ found that discretion was owed to a trustee only when the terms of the trust agreement specifically gave the trustee such discretion.¹³⁰ When the authorization for the trustee to exercise discretion is absent, the proper role of a court is to interpret the terms of the trust without giving deference to either party.¹³¹ When the trust agreement is written, courts should look at the language of the agreement and also consider other evidence, such as the circumstances and intent.¹³²

This procedure, basically a contract interpretation standard, was used to review employee benefit claims arising before the enactment of ERISA.¹³³ The Court noted that the intent of ERISA was to protect the contractual rights of employees to benefit plans and generally further the interests of employees in employee benefits.¹³⁴ However, allowing the trustees of such plans broad discretion in administration actually gave employees less protection than before ERISA's enactment.¹³⁵ As one commentator has noted, several courts, in exercising discretionary review, have upheld the fiduciary's decision when in fact, if the courts had applied a de novo review of the contracts, they would have

121. *Id.*

122. *Id.*

123. *Id.* at 145.

124. *Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101 (1989).

125. *Id.* at 108, 115.

126. *Id.* at 109.

127. *Id.* at 110. *See also supra* notes 43-58 and accompanying text.

128. 489 U.S. at 111-12, 115.

129. *Id.* at 111-12.

130. *Id.*

131. *Id.* at 112.

132. *Id.*

133. *Id.*

134. *Id.*

135. *Id.* at 113-14.

reached an opposite result.¹³⁶ Accordingly, the Supreme Court found that the arbitrary and capricious review of employee benefit plans contravened the intent of ERISA.¹³⁷

The de novo review mandated by the Supreme Court will afford greater protection to employees because ERISA fiduciaries will no longer have the almost carte blanche authority to interpret terms of the plan agreements. However, the de novo review is only applicable to disputes arising from the interpretation of plan language. Additionally, the Supreme Court in *Bruch* specifically exempted de novo review from situations in which the benefit plan explicitly gave the fiduciary the power to construe the terms of the plan.¹³⁸ The new standard does nothing to prevent a fiduciary/employer from putting on its employer hat and adding a clause giving the fiduciary discretion or changing any of the other terms of the plan. Presumably union employees will be able to protect themselves from this type of employer action since the welfare benefit plans are negotiated and become part of the collective bargaining agreement. However, most salaried employees, being employees at will, do not have this type of protection.

B. *The Rise and Fall of the Status Benefit Theory*

One approach to deal with the inequity of an employer's power to terminate or modify welfare benefit plans was the status benefit theory, a concept created by the federal courts pursuant to their judicial law-making authority.¹³⁹ The courts, recognizing that ERISA did not provide vesting requirements for welfare benefit plans as it did for pension plans,¹⁴⁰ attempted to fill this void by developing a common law theory that welfare benefits vested per se upon an employee's retirement. However, as will be discussed, the theory never became widely recognized and was rejected by most courts.

The idea of the status benefit theory first appeared in *UAW v. Yard-Man, Inc.*¹⁴¹ This case involved a collective bargaining agreement, entered into in 1974 between Yard-Man and the union. Subsequently, Yard-Man closed its plant and informed retirees that their health and life insurance benefits would be terminated at the expiration of the collective bargaining agreement.¹⁴² The union brought suit and obtained a favorable judgment. The court found that the welfare benefits had vested in those who had retired and that the benefits were to continue indefinitely.¹⁴³ The *Yard-Man* court based its decision solely on traditional contract theory.¹⁴⁴ However, the court also added that "retiree benefits are in a sense 'status' benefits which, as such, carry with them an inference

136. Page, *supra* note 87, at 501.

137. *Firestone Tire & Rubber Co.*, 489 U.S. at 113-14.

138. *Id.*

139. *See supra* notes 43-59 and accompanying text.

140. *See supra* note 37 and accompanying text.

141. 716 F.2d 1476 (6th Cir. 1983).

142. *Id.* at 1478.

143. *Id.* at 1481.

144. *Id.* at 1479-80.

that they continue so long as the prerequisite status is maintained."¹⁴⁵ That is, "when the parties contract for benefits which accrue upon achievement of retiree status, there is an inference that the parties likely intended those benefits to continue as long as the beneficiary remains a retiree."¹⁴⁶

Later, in *Eardman v. Bethlehem Steel Corp.*,¹⁴⁷ the District Court for the Western District of New York gave weight to the status theory set forth in *Yard-Man*.¹⁴⁸ This case was basically decided on contract theory. The court found that despite a clause in the single plan document in which the company reserved the right to reduce or terminate retirement welfare benefits, extrinsic evidence indicated that the company did not intend to reserve the right to alter or terminate benefits.¹⁴⁹ The evidence relied on by the court included other documents given to employees and statements made to retirees during their exit interviews, all of which indicated that welfare benefits would be provided throughout their lifetimes.¹⁵⁰ However, the court also cited the status benefit theory set forth in *Yard-Man*.¹⁵¹

While the court agreed with *Yard-Man* in that there is an implication that retiree benefits vest upon the time the employee reaches the status of retirement, it held that "such implication, in and of itself would be insufficient to support a finding of an intent to establish interminable benefits."¹⁵² Therefore, the *Eardman* court used the status benefit theory as one factor among many in determining that welfare benefits had vested.

The status benefit theory reached the high-water mark in the case of *In Re White Farm Equipment Co.*¹⁵³ in which the District Court for the Northern District of Ohio held that welfare benefits vest upon retirement.¹⁵⁴ Once the employee retires, thus causing the benefits to vest, the employer cannot terminate or reduce the benefits even if the plan language specifically authorized such action.¹⁵⁵ The court found authority for this principle in the fact that ERISA was silent on the issue of welfare benefits vesting and federal courts were allowed to formulate law where ERISA left gaps.¹⁵⁶

The employer appealed the District Court's decision to the Sixth Circuit Court of Appeals.¹⁵⁷ The Sixth Circuit rejected the absolute vesting rule set forth by the District Court due to lack of precedential support.¹⁵⁸ The court remained neutral on Congress' exemption of welfare benefit plans from the vesting scheme of pension plans. While the court did not interpret congressional

145. *Id.* at 1482.

146. *Id.*

147. 607 F. Supp. 196 (W.D.N.Y. 1984), *appeal dismissed*, 755 F.2d 913 (2d Cir. 1985).

148. *See supra* notes 145-46 and accompanying text.

149. *Bethlehem Steel*, 607 F. Supp. at 198.

150. *Id.* at 209.

151. *Id.*

152. *Id.*

153. 42 B.R. 1005 (N.D. Ohio 1984), *rev'd*, 788 F.2d 1186 (6th Cir. 1986).

154. *Id.* at 1016-19.

155. *Id.*

156. *Id.* at 1014-16.

157. *In re White Farm Equip. Co.*, 788 F.2d 1186 (6th Cir. 1986).

158. *Id.* at 1192-93.

silence to mean that welfare benefits do not vest,¹⁵⁹ it also refused to impose a judicial rule mandating vesting.¹⁶⁰ The court stated that the legislature, rather than the courts, is the proper body to determine this issue.¹⁶¹

Other courts have agreed with the Sixth Circuit's rejection of a status benefit rule imposing mandatory vesting. The Eighth Circuit, in *Anderson v. Alpha Portland Industries, Inc.* rejected the concept of per se status vesting and refused to recognize an inference of an intent to vest upon reaching the status of a retiree.¹⁶²

C. Contract Theory

The Sixth Circuit in *White* ultimately determined that the welfare benefit plan was ambiguous as to whether the employer had reserved the right to terminate welfare benefits.¹⁶³ The court admitted extrinsic evidence to determine the parties' intent.¹⁶⁴ This approach represents a straight forward application of contract principles, similar to the approach advocated by the Supreme Court in *Bruch*.¹⁶⁵ The courts in *Yard-Man* and *Eardman*, although approving of the status benefit theory, found independent support for the holdings in contract law.¹⁶⁶ The majority of cases determining whether retired employees are entitled to welfare benefits have followed these courts in applying contract analysis.¹⁶⁷ As mentioned in the above cases, courts will generally look first to the plan language, but will also consider extrinsic evidence to determine whether the employer may alter or terminate welfare benefits.¹⁶⁸

IV. CONCLUSION

Since employers are not required to provide retirement welfare benefits such as health insurance, and given the escalating costs of providing these benefits, it is certainly reasonable that employers should be able to contractually specify (or in the union context negotiate) what benefits are to be provided and to state whether they reserve the right to modify or terminate the benefits. As long as the employer clearly states its position to the employee, the employee can plan for his or her retirement needs.

Unfortunately, the above procedure is rarely followed in the real world. Instead, many employees find themselves in the situation of Willy Loman in *Death of a Salesman*. Employers made promises, employees relied on them, and

159. *Id.* at 1192.

160. *Id.* at 1193.

161. *Id.*

162. 836 F.2d 1512 (8th Cir. 1988), *cert. denied sub. nom.*, *Anderson v. Slattery Group, Inc.*, 489 U.S. 1051 (1989).

163. *In re White Farm Equip. Co.*, 788 F.2d at 1193-94.

164. *Id.* at 1193.

165. *See supra* text accompanying notes 123-36.

166. *See supra* text accompanying notes 141-52.

167. *See Comment, Retiree Welfare Benefits: ERISA, LMRA and the Federal Common Law*, 20 AKRON L. REV. 455, 460-68 (1987).

168. *Id.*

suddenly employees find themselves discarded by the employers who fail to honor the promises.

This situation manifests itself in basically two ways with retiree welfare benefits. First, the employer may reserve termination/modification rights in the plan document required by ERISA, but represent to the employee that the benefits are for life. Some courts, if they are sympathetic to the employees, will consider this extrinsic evidence as the employer's intent to provide the benefits without change or termination. Other courts, recognizing the potentially devastating cost of providing these unfunded benefits, will allow the employers to reduce or terminate benefits.

The second situation occurs when at the time an employee is hired, the employer agrees to provide lifetime welfare benefits. However, after the employee has served the company, perhaps for many years, or has retired from the company, the employer changes the plan language so as to allow it to alter or terminate the welfare benefits.

In both scenarios the employee has relied on the promises. When the employer modifies or refuses to provide benefits, it may be too expensive for an employee to obtain similar insurance coverage. For example, a sixty-year-old with cancer, a disease that can financially devastate without insurance coverage, will find it difficult to obtain insurance, and will be ineligible for Medicare because he is not sixty-five.

I believe the only solution to these problems is to subject employee welfare plans to the vesting requirements similar to ERISA pension plans. To assure the vested benefits will actually be paid, employers should be required to fund the plans. Vesting and funding are effective ways for employers to contain liabilities while providing employees stability in planning for retirement. However, since ERISA remains silent in this area and courts believe they lack authority to fill the voids of ERISA, Congress must be the one to act.

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