

# Washington University Law Review

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Volume 76 | Issue 1

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1998

## ERISA's Curious Coverage

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### Recommended Citation

Peter J. Wiedenbeck, *ERISA's Curious Coverage*, 76 WASH. U. L. Q. 311 (1998).

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# ERISA'S CURIOUS COVERAGE\*

PETER J. WIEDENBECK\*\*

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## I. INTRODUCTION

This article is about the scope of federal regulation of employee benefit plans under the Employee Retirement Income Security Act of 1974 ("ERISA").<sup>1</sup> ERISA establishes four levels of increasingly intense regulation for different types of benefit programs. First, those fringe benefit arrangements that do not satisfy the statutory definitions of an "employee welfare benefit plan" or an "employee pension benefit plan" are excluded from federal oversight, but may be subject to state or local regulation.<sup>2</sup> Second, programs that meet the definition of a welfare plan are subject to

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1. Employee Retirement Income Security Act of 1974 ("ERISA"), Pub. L. No. 93-406, 88 Stat. 829 (1974) (codified as amended in 29 U.S.C. §§ 1001-1461 (1994) and in scattered sections of the Internal Revenue Code, 26 U.S.C. §§ 1-9722 (1994)).

2. ERISA §§ 3(1)-(3), 4(a), 514(a), 29 U.S.C. §§ 1002(1)-(3), 1003(a), 1144(a) (1994).

federal reporting and disclosure rules, federal fiduciary standards, and a federal enforcement mechanism (applicable to both the statutory obligations and the terms of the plan) that entirely supplants state law.<sup>3</sup> Under this approach, ERISA generally monitors only the implementation or *conduct* of privately-constituted welfare plans, it does not control their *content*.<sup>4</sup> Third, defined contribution pension plans are subject to the same conduct controls as welfare plans, and their content must also measure up to certain minimum standards that, among other things, restrict the use of age and service conditions on plan membership,<sup>5</sup> require employer-financed pension benefits to “vest” or become non-forfeitable after a reasonable period of service,<sup>6</sup> provide a surviving or divorced spouse access to the pension,<sup>7</sup> and preclude alienation of the participant’s interest.<sup>8</sup> Fourth, defined benefit pension plans are subject to all those requirements and more, including minimum rates of benefit accrual,<sup>9</sup> minimum funding standards,<sup>10</sup> coverage under the Pension Benefit Guaranty Corporation (“PBGC”) termination insurance program,<sup>11</sup> and restrictions on termination.<sup>12</sup>

This pattern of increasingly stringent oversight was adopted to accomplish four goals. Controlling mismanagement and abuse of employee benefit funds was a central objective—federal fiduciary standards were enacted because prevailing state law was not up to the task. While drawing on general principles of trust law, ERISA’s fiduciary standards include two fundamental departures from prevailing state law. First, the statutory definition of fiduciary extends far beyond state law trustees and imposes standards of competence and fair dealing on anyone who has or exercises any discretionary authority in the administration of the plan or who is involved in the management of its assets, and on investment advisors as well.<sup>13</sup> Second,

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3. ERISA §§ 3(1), 101(a), 401(a), 502, 514(a), 29 U.S.C. §§ 1002(1), 1021(a), 1101(a), 1132, 1144(a) (1994).

4. In a departure from this traditional hands-off approach to welfare plan content, ERISA was amended in 1996 to require that group health plans satisfy minimum standards relating to health insurance portability and access. *See* ERISA §§ 701-34, 29 U.S.C.A. §§ 1181-91c (Supp. 1998).

5. ERISA § 202, 29 U.S.C. § 1052 (1994).

6. ERISA § 203, 29 U.S.C. § 1053 (1994).

7. ERISA §§ 205, 206(d)(3), 514(b)(7), 29 U.S.C. §§ 1055, 1056(d)(3), 1144(b)(7) (1994).

8. ERISA § 206(d)(1), 29 U.S.C. § 1056(d)(1) (1994).

9. ERISA § 204, 29 U.S.C. § 1054 (1994).

10. ERISA §§ 301-08, 29 U.S.C. §§ 1081-86 (1994).

11. ERISA §§ 4021(a), (b)(1), 4001-4402, 29 U.S.C. §§ 1321(a), (b)(1), 1301-1461 (1994).

12. ERISA §§ 4041-42, 29 U.S.C. §§ 1341-42 (1994).

13. ERISA § 3(21)(A), 29 U.S.C. § 1002(21)(A) (1994); *see* S. REP. NO. 93-127, at 29 (1973), *reprinted in* 1 SUBCOMM. ON LABOR OF THE SENATE COMM. ON LABOR AND PUBLIC WELFARE, 94TH CONG., 2D SESS., LEGISLATIVE HISTORY OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974, at 587, 615 (Comm. Print 1976) [hereinafter ERISA LEGISLATIVE HISTORY] (concluding fiduciary responsibility provisions were necessary because “it is unclear whether the traditional law of

ERISA voids any attempt to relax its stringent fiduciary obligations through the inclusion of exculpatory clauses in the plan, even though such indulgences are common and effective under state law.<sup>14</sup> Mismanagement and abuse are also deterred by requiring disclosure of the principal terms of the plan and its current financial status. Should deterrence fail, disclosure allows participants and beneficiaries to monitor the plan's administration and enforce their rights.

Disclosure also furthers the second central goal of ERISA, promoting economic efficiency by facilitating improved career and financial planning.<sup>15</sup> Disclosure gives workers the information they need to make an informed evaluation of competing job opportunities and to accommodate their personal financial affairs to the employer's program (by allowing them to determine their need for additional savings or insurance, for example).

In the case of pension plans ERISA goes beyond disclosure and the

trusts is applicable [to certain] plans, such as insured plans, that do not use the trust form as their mode of funding."). While the extension of fiduciary obligations to insurance and annuity plans was deliberate and well understood, including as fiduciaries all persons with any discretionary authority in plan administration (in addition to those who have a role in the management or disposition of assets) seems to have escaped congressional attention.

14. See ERISA § 410(a), 29 U.S.C. § 1110(a) (1994). The Senate report explained:

[R]eliance on conventional trust law often is insufficient to adequately protect the interests of plan participants and beneficiaries. This is because trust law had developed in the context of testamentary and inter vivos trusts . . . with an attendant emphasis on carrying out the instructions of the settlor. Thus, if the settlor includes in the trust document an exculpatory clause under which the trustee is relieved from liability for certain actions which would otherwise constitute a breach of duty, or if the settlor specifies that the trustee shall be allowed to make investments which might otherwise be considered imprudent, the trust law in many states will be interpreted to allow the deviation. In the absence of a fiduciary responsibility section in the present Act, courts applying trust law to employee benefit plans have allowed the same kinds of deviations, even though the typical employee benefit plan . . . is quite different from the testamentary trust both in purpose and nature.

S. REP. NO. 93-127, at 29 (1973), *reprinted in* 1 ERISA LEGISLATIVE HISTORY, *supra* note 13, at 587, 615.

15. ERISA requires that participants and beneficiaries be supplied with a summary plan description. ERISA § 101(a)(1), 29 U.S.C. § 1021(a)(1) (1994), which "shall be written in a manner calculated to be understood by the average plan participant, and shall be sufficiently accurate and comprehensive to reasonably apprise such participants and beneficiaries of their rights and obligations under the plan." ERISA § 102(a)(1), 29 U.S.C. § 1022(a)(1) (1994). This summary plan description (SPD) was made the participants' principal source of information on plan content because:

It is grossly unfair to hold an employee accountable for acts which disqualify him from benefits, if he had no knowledge of these acts, or if these conditions were stated in a misleading or incomprehensible manner in plan booklets. Subcommittee findings were abundant in establishing that an average plan participant, even where he has been furnished an explanation of his plans provisions, often cannot comprehend them because of the technicalities and complexities of the language used.

S. REP. NO. 93-127, at 11 (1973), *reprinted in* 1 ERISA LEGISLATIVE HISTORY, *supra* note 13, at 587, 597.

regulation of fiduciary conduct to impose minimum standards on certain plan terms, thereby accomplishing the third statutory objective: assuring that the promise of a pension has some minimum content. Such content regulation is generally considered paternalistic—it is assumed that the justification for restricting freedom of contract under a regime of full disclosure lies in a concern that many participants would not make proper use of the information available to them.<sup>16</sup> But minimum standards of pension plan content can also be viewed as an attempt to promote better decisionmaking by standardizing certain key contract terms in order to avoid information overload.<sup>17</sup>

Thus, controlling mismanagement and abuse of benefit programs, increasing economic efficiency through improved career and financial planning, and protecting workers with pension quality standards are the chief purposes of federal benefit regulation. But these purposes are subject to an important qualification. Congress sought to accomplish these objectives without fundamentally altering the nature of employee benefit programs—the system was to remain private, voluntary, and employment-based.<sup>18</sup>

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16. Underestimation of the risk of pension loss due to factors such as forfeiture conditions, underfunding, fiduciary misconduct, or employer insolvency would cause workers to overvalue unregulated pension promises. Consistent overvaluation would permit employers to charge more for pension plan coverage, via reduced wages or other benefits, than such contingent retirement savings are really worth. Under such conditions, substantive regulation to reduce the risk of pension loss might bring the real worth of plan coverage into line with workers' inflated estimation, increasing their welfare. From this standpoint, ERISA's pension plan content controls can be viewed as an instance of consumer protection legislation—disclosure being ineffective in this area, protection took the form of minimum standards of product quality. *See infra* note 70.

17.

For most workers, the cost of evaluating the specialized terms and particular finances of numerous alternative plans (associated with different employment opportunities) may exceed the benefit of a marginally more valuable pension. Information costs may be reduced by limited standardization (*i.e.*, restricting the variance) of key contract terms. By reducing job search costs, such content regulation may increase economic efficiency.

From the information cost perspective, pension content controls complement the disclosure regime. Disclosure provides access to information, while content controls limit the volume of information to a manageable level. Together, they facilitate career and financial planning.

Peter J. Wiedenbeck, *Implementing ERISA: Of Policies and "Plans"*, 72 WASH. U. L.Q. 559, 574 (1994). ERISA also standardizes all *implied* terms of *both* pension and welfare plans by imposing uniform fiduciary obligations and authorizing the development of a federal common law of benefit plans to replace preempted state law. *See id.* at 576.

18. Senator Jacob K. Javits, the foremost legislative proponent of comprehensive federal pension regulation explained:

The problem, as perceived by those who were with me on this issue in the Congress, was how to maintain the voluntary growth of private plans while at the same time making needed structural reforms in such areas as vesting, funding, termination, etc., so as to safeguard workers against loss of their earned or anticipated benefits—which was their principal cause of complaint and which, over the years, had led to widespread frustration and bitterness. [The] new law represents an overall effort to strike a balance between the clearly-demonstrated needs of workers for greater protection and the desirability of avoiding the homogenization of pension plans into a federally-

Consequently, employers will decline to sponsor plans if costs become too high. By virtue of this opt-out, the regulation of employee benefits entails a delicate balance—measures intended to improve the quality of health insurance or retirement programs, if taken too far, deter some employers from providing such benefits at all. Because the availability of benefits depends on employer decisionmaking, ERISA necessarily incorporates a fourth, and competing, objective: cost containment and the preservation of employer flexibility.

This article examines the fit between these policy goals and existing interpretations of ERISA's reach. It shows that although the statute's anti-abuse and protective policies have been influential in defining the scope and extent of benefit plan regulation, neither is pursued with single-minded consistency. In the main, this inconsistency is traceable to historical circumstance rather than reasoned compromise between competing objectives.

## II. DISCUSSION

Congress relied on the Commerce Clause as the basis for its power to regulate employee benefit plans. ERISA applies to any "employee benefit plan" established or maintained by an employer "engaged in commerce or in any industry or activity affecting commerce," as well as to plans established or maintained by unions representing employees so engaged.<sup>19</sup> The statute broadly defines "commerce" and "industry or activity affecting commerce" to reach most any employer or union, regardless of size.<sup>20</sup>

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dictated structure that would discourage voluntary initiatives for further expansion and improvement.

Senator Jacob K. Javits, Address at the Briefing Conference on Pension and Employee Benefits (Sept. 19, 1974), *quoted in* Michael S. Gordon, *Overview: Why Was ERISA Enacted?*, in SENATE SPECIAL COMM. ON AGING, 98TH CONG., 2D SESS., THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974: THE FIRST DECADE 25 (Comm. Print 1984).

19. ERISA § 4(a), 29 U.S.C. § 1003(a) (1994).

20. See ERISA § 3(11), (12), 29 U.S.C. § 1002(11), (12) (1994); *Fugarino v. Hartford Life & Accident Ins. Co.*, 969 F.2d 178 (6th Cir. 1992) (finding group health insurance provided by small family-owned restaurant was subject to ERISA, notwithstanding the business' trivial impact on commerce).

ERISA's definitions of "commerce" and "industry or activity affecting commerce" were carried over verbatim from a predecessor statute, the Welfare and Pension Plans Disclosure Act of 1958, Pub. L. No. 85-836, § 3(10), (11), 72 Stat. 997, as amended by Pub. L. No. 87-420, 76 Stat. 35, repealed by ERISA § 111(a)(1), 29 U.S.C. § 1031(a)(1) (1994) [hereinafter WPPDA]. That definition was in turn taken from the jurisdictional provision of the Taft-Hartley Act, 29 U.S.C. § 142(1) (1994). See 104 CONG. REC. 16,437-38 (1958) (remarks of Reps. Barden, Frelinghuysen, and Green) (discussing the prudence of using the language of the Taft-Hartley Act, § 142(1), in the WPPDA). Under Taft-Hartley it is sufficient if the industry as a whole affects commerce; it is not necessary that the particular

Enterprise size does not seriously restrict ERISA's scope, but federal controls come into play only if there is an "employee benefit plan." The definition of employee benefit plan imposes three important limitations on ERISA's coverage. First, the arrangement for the provision of benefits must constitute a "plan, fund or program." Second, the plan must provide benefits to employees or their beneficiaries. Third, the benefits provided must be of a type specified in either the definition of a "welfare plan" or a "pension plan."<sup>21</sup> Each of these criteria implicates fundamental interpretive and policy issues that are examined below. The discussion concludes with an exploration of legislative exceptions that render certain employee benefit plans largely or completely exempt from federal regulation.

#### A. The "Plan" Prerequisite

An arrangement for the provision of benefits must be a "plan, fund, or program" to be subject to ERISA.<sup>22</sup> The statute offers no definition of these terms. Judicial efforts to supply a definition have encountered three sorts of issues. First, the decisions reveal that the presence of either an ongoing administrative program for processing claims and paying benefits, or some person having the status of a fiduciary, is necessary to support the finding of a plan. Second, certain arrangements to provide benefits may be too indefinite to create a plan. Third, where a benefit is provided to a very small number of employees, it is often asserted that coverage is too restricted to constitute a plan.

##### 1. Ongoing Administration or Fiduciary Status<sup>23</sup>

Where an employee benefit can be provided without establishing an ongoing administrative apparatus there is no "plan," provided that the obligation is unfunded and nondiscretionary. This conclusion follows from a line of cases tracing back to *Fort Halifax Packing Co. v. Coyne*.<sup>24</sup> There, the Supreme Court held that a Maine law requiring one-time severance payments in the event of a plant closing was not preempted by ERISA because it

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enterprise in which the employer or unionized employees are engaged affects commerce. *E.g.*, *United States v. Ricciardi*, 357 F.2d 91, 95 (2d Cir. 1966) (saying the relevant industry "comprises all business activities in the same field").

21. ERISA § 3(3), (1), (2)(A), 29 U.S.C. § 1002(3), (1), (2)(A) (1994).

22. ERISA §§ 4(a), 3(3), (1), (2)(A), 29 U.S.C. §§ 1003(a), 1002(3), (1), (2)(A) (1994).

23. Part of the following discussion is derived from Wiedenbeck, *supra* note 17, at 586-89, 591-93.

24. 482 U.S. 1 (1987).

“neither establishes, nor requires an employer to maintain, an employee welfare benefit ‘plan.’”<sup>25</sup> The Court distinguished its earlier summary affirmance of decisions holding an unfunded severance program subject to ERISA because the program in those cases created an ongoing commitment to pay benefits as each person left employment and so required a continuing administrative scheme.<sup>26</sup> Equating an ERISA plan with an “ongoing administrative program for processing claims and paying benefits”<sup>27</sup> was supported by the policy of preemption: conforming a benefit program to a patchwork of state regulation would forfeit the advantages of uniform administrative practice, whereas a contingent one-time obligation to make nondiscretionary lump-sum payments entails no such inefficiency.<sup>28</sup> The Court also observed that the Maine plant-closing law “not only fails to implicate the concerns of ERISA’s pre-emption provision, it fails to implicate the regulatory concerns of ERISA itself.”<sup>29</sup> Looking to the legislative history of ERISA’s fiduciary responsibility rules (which apply to both pension and welfare plans), the Court concluded that “[t]he focus of the statute thus is on the administrative integrity of benefit plans—which presumes that some type of administrative activity is taking place.”<sup>30</sup>

Lower court decisions involving employer-initiated severance programs

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25. *Id.* at 6.

26. *See id.* at 17-19 (distinguishing *Holland v. Burlington Indus., Inc.*, 772 F.2d 1140 (4th Cir. 1985), *summarily aff’d*, 477 U.S. 901 (1986), and *Gilbert v. Burlington Indus., Inc.*, 765 F.2d 320 (2d Cir. 1985), *summarily aff’d*, 477 U.S. 901 (1986)).

27. *Fort Halifax*, 482 U.S. at 12.

28. *See id.* at 8-15. The *Fort Halifax* majority observed that “Congress intended pre-emption to afford employers the advantages of a uniform set of administrative procedures governed by a single set of regulations.” *Id.* at 11. Yet employers could secure the cost advantages of a single set of administrative procedures by including a choice of law provision in their benefit plans. This consideration suggests that it is workers who benefit through lower information costs from having all plans subject to the *same* set of supplementary rules.

The Court in *Fort Halifax* relied on precedent to support its conclusion that preemption serves the employer’s cost interest in uniformity, *see id.* at 10-13, but the cases relied upon involved state-mandated benefits rather than differing administrative procedures. *Cf. Alessi v. Raybestos-Manhattan, Inc.*, 451 U.S. 504 (1981) (holding that ERISA preempted a New Jersey statute that prohibited offsetting workers’ compensation payments against pension benefits); *Standard Oil Co. v. Agsalud*, 633 F.2d 760 (9th Cir. 1980), *summarily aff’d*, 454 U.S. 801 (1981) (holding that ERISA preempted a Hawaii law mandating employer provision of specified health insurance benefits). In the context of mandated benefits, unlike administrative procedures, the employer does have a cost-based interest in preemption. In a dissenting opinion Justice White, joined by three other members of the Court, observed that *Agsalud* “involved more than administrative uniformity,” and contended that the Maine plant-closing statute, which also involved mandated benefits, should be preempted. *See Fort Halifax*, 482 U.S. at 24-26. This suggests that the majority’s incomplete analysis of the policy of preemption (i.e., overlooking the employees’ interest in uniformity and the employer’s interest in laissez-faire) may have led the Court to adopt an unduly narrow approach to preemption.

29. *Fort Halifax*, 482 U.S. at 15.

30. *Id.*



have fleshed out the scope of *Fort Halifax*. Arrangements to make a readily-determinable lump-sum cash payment have been found not to constitute an ERISA plan.<sup>31</sup> Yet some short-term commitments calling for payment in a lump sum have been subjected to federal regulation, notwithstanding the Supreme Court's search for an ongoing administrative program. Comparison of the decisions demonstrates that if there is no continuing administrative apparatus, then ERISA's application turns on the presence or absence of *discretion* in processing benefit claims.

Many of the leading cases involve *unfunded* executive severance ("golden parachute") programs. In *Fontenot v. NL Industries, Inc.*<sup>32</sup> the employer adopted, as one component of a takeover defense, a plan providing that selected senior executives would receive a lump-sum cash severance payment in an amount equal to three times the highest annual compensation received in the preceding three years if employment was terminated *for any reason* within two years of a change in control of the corporation.<sup>33</sup> The plaintiff, who was not included in the program, was terminated one year after a takeover. He sued for benefits under federal law, but the employer was granted summary judgment on the ground that ERISA did not apply.<sup>34</sup>

In contrast, ERISA has been applied to other golden parachute programs. It may seem startling that a labor law enacted to protect workers' interests sometimes extends to managers' efforts to protect themselves in the event of a change in corporate control. But if the severance allowance entails a *discretionary* determination (as to eligibility or amount), safeguards are needed to prevent abuse. Cases such as *Bogue v. Ampex Corp.*<sup>35</sup> vividly illustrate the breadth of the statute. There a program covering ten executives of a subsidiary that was to be sold called for severance payments if an executive was not offered "substantially similar employment" within 10 months after the sale. The Ninth Circuit stated:

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31. See *Angst v. Mack Trucks, Inc.*, 969 F.2d 1530 (3d Cir. 1992); *Fontenot v. NL Indus., Inc.*, 953 F.2d 960 (5th Cir. 1992); *Wells v. General Motors Corp.*, 881 F.2d 166 (5th Cir. 1989).

32. 953 F.2d 960 (5th Cir. 1992).

33. See *id.* at 961, 963.

34. *Id.* at 961.

35. 976 F.2d 1319 (9th Cir. 1992). The Ninth Circuit has subsequently limited *Bogue* by holding that an individually-negotiated executive employment contract that called for readily-determinable severance payments in the event of termination "without cause" did not establish an ERISA plan. See *Delaye v. Agripac, Inc.*, 39 F.3d 235 (9th Cir. 1994). According to the court, this single discretionary determination—unlike the 10 decisions possible in *Bogue*—did not require "ongoing discretionary analysis." *Id.* at 238. The analysis in *Delaye* conflates the search for continuing (nondiscretionary) administrative activity with the search for discretionary decisionmaking. ERISA's policies of preventing employer abuse and protecting participants indicate that a single judgment call should result in plan classification, so that federal fiduciary oversight is triggered.

In this case, Allied-Signal, the program's administrator, remained obligated to decide whether a complaining employee's job was "substantially equivalent" to his pre-acquisition job. Although the program, like the plans in *Fort Halifax* and *Wells*, was triggered by a single event, that event would occur more than once, at a different time for each employee. There was no way to carry out that obligation with the unthinking, one-time, nondiscretionary application of the plan administrators [as] in *Fort Halifax* and *Wells*. Although its application was uncertain, its term was short, and the number of its participants was small, the program's administration required a case-by-case, discretionary application of its terms. Whether or not Allied-Signal ever thought [that the program would be subject to ERISA] does not matter. . . . We hold that Allied-Signal was obligated to apply enough ongoing, particularized, administrative, discretionary analysis to make the program in this case a "plan."<sup>36</sup>

Similarly, the Third Circuit held that a plan that required a separate determination of each covered executive's eligibility for benefits (specifically, whether post-merger termination was for reasons other than cause) was an ERISA plan.<sup>37</sup>

This focus on administrative discretion seems sensible in light of the *Fort Halifax* policy analysis: if preventing mismanagement and abuse by fiduciaries is the central tenet of ERISA, perhaps ERISA should not apply where there are no judgment calls to oversee. Two elements of ERISA support such a conclusion. First, ERISA's fiduciary duty and prohibited transactions rules apply only to fiduciaries,<sup>38</sup> whom the statute broadly defines as any person who has or exercises "any discretionary authority" in the management or administration of the plan.<sup>39</sup> Second, this approach is consistent with the limited abuse-of-discretion standard of review that is applied to benefit claim denials where the plan gives the fiduciary discretionary authority to determine eligibility for benefits or to construe the

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36. Bogue, 976 F.2d at 1323. *Accord* *Schonholz v. Long Island Jewish Med. Ctr.*, 87 F.3d 72, 76 (2d Cir. 1996), *cert. denied*, 117 S. Ct. 511 (1996); *Cvelbar v. CBI Illinois, Inc.*, 106 F.3d 1368, 1376 (7th Cir. 1997), *cert. denied*, 118 S. Ct. 56 (1997).

37. See *Pane v. RCA Corp.*, 667 F. Supp. 168, 170-71 (D.N.J. 1987), *aff'd*, 868 F.2d 631 (3d Cir. 1989). See also *Kulinski v. Medtronic Bio-Medicus, Inc.*, 21 F.3d 254, 258 (8th Cir. 1994) (holding an agreement calling for severance pay in the event of resignation for good reason within one year of a hostile takeover did not create an ERISA plan because it gave the *employee* unfettered discretion to decide whether he had good reason to resign; the court noted that a plan exists where the *employer* "must analyze each employee's particular circumstances in light of the appropriate criteria" to determine benefit eligibility or amount).

38. ERISA §§ 404(a), 406, 29 U.S.C. §§ 1104(a), 1106 (1994).

39. ERISA § 3(21)(A), 29 U.S.C. § 1002(21)(A) (1994).

terms of the plan.<sup>40</sup>

The presence of a discretionary determination should not be the exclusive trigger of ERISA, however. Preventing mismanagement and abuse by fiduciaries is a central tenet of ERISA, but mishandling of plan assets is as much a threat to the integrity of benefit plans as abusive decisionmaking is. ERISA's fiduciary responsibility provisions were intended to prohibit outright thievery and looting of benefit funds by anyone with access to the fund, however exalted or subordinate her position. Accordingly, oversight of discretionary decisionmaking alone is not enough to protect workers' interests. ERISA should apply *either* if the benefit obligation involves the exercise of discretion *or* if it is advance-funded. ERISA's drafters understood this point—if the plan is funded, any person who “exercises any authority or control respecting management or disposition of its assets” is a fiduciary, whether or not that authority involves the exercise of discretion.<sup>41</sup> Plan trustees are always fiduciaries, as are other people who handle plan assets, even if their duties are purely ministerial (an agent of the trustee, for example).<sup>42</sup> Yet the protection Congress intended to afford in the definition of fiduciary is illusory if the statute fails to apply for want of a plan. To safeguard workers from *both* oppressive decisions *and* looting of the fund, the core jurisdictional principle should be: where there is a fiduciary, there is a plan.

*Fort Halifax* supports an even more wide-ranging definition of plan, one that would consider the presence of ongoing administrative activity as well as the presence of a fiduciary. Although the severance payments required by the Maine plant-closing statute in *Fort Halifax* were unfunded and nondiscretionary (the employer's obligation could be discharged without the service of an ERISA fiduciary), the Court's opinion indicates that ERISA would apply if there were “an ongoing administrative program for processing claims and paying benefits.”<sup>43</sup> Apparently, then, a regular or continuing benefit obligation would trigger ERISA even if that obligation is unfunded

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40. See *Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101, 115 (1989).

41. See ERISA § 3(21)(A)(i), 29 U.S.C. § 1002(21)(A)(i) (1994).

42. See 29 C.F.R. § 2509.75-8 (D-2) (1997) (stating that persons who perform various functions “within a framework of policies, interpretations, rules, practices and procedures made by other persons” are not fiduciaries, but of the listed “ministerial functions” only one—“collection of contributions and application of contributions as provided in the plan”—involves handling assets); see also *Anoka Orthopaedic Assocs., P.A. v. Mutschler*, 709 F. Supp. 1475, 1482-83 (D. Minn. 1989), *aff'd*, 910 F.2d 514 (8th Cir. 1990) (holding that the attorney and the accountant who prepared year-end financial statements, conducted limited audits, and provided other services that did not involve investment or handling of plan assets were not fiduciaries).

43. *Fort Halifax Packing Co. v. Coyne*, 482 U.S. at 1, 12 (1987).

and nondiscretionary.<sup>44</sup> This connotation of “plan” may take into account the view that, although “ERISA’s central focus [is on] administrative integrity,” fiduciary responsibility is not the only component of federal benefit plan regulation. In particular, workers must be informed of the extent of the benefit obligation (coverage, amount and timing) and the method for “processing claims and paying benefits” in order to take full advantage of the program.<sup>45</sup> Ongoing administration by itself implicates informational interests, and so it should trigger ERISA’s reporting and disclosure regime.<sup>46</sup>

This judicially-developed definition of plan (requiring either ongoing administration or the presence of a fiduciary) is rightly informed by the goals of ERISA. It also has some textual support. Recall that ERISA defines both a welfare plan and a pension plan as a “plan, *fund*, or *program*.”<sup>47</sup> Use of the term “fund” indicates that ERISA applies whenever the obligation is advance-funded. Funding, of course, requires continuing oversight and assures that there will be someone with fiduciary status. “Program” implies an ordered sequences of events (such as a procedure for processing claims and paying benefits), which lends credence to the distinction between ongoing administration and a one-time lump-sum payment.

## 2. *Indefiniteness*

To be subject to federal regulation a welfare or pension plan must be “established or maintained by an employer or by an employee organization.”<sup>48</sup> That is, the plan must already have come into existence. A tentative or projected benefit arrangement is not a plan, or (equivalently) has not been “established.”<sup>49</sup>

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44. See *id.* at 18 nn. 10 & 12 (distinguishing a benefit obligation that entails “regularity of payment”).

45. See ERISA §§ 101(a)(1), 102, 29 U.S.C. §§ 1021(a)(1), 1022 (1994) (summary plan description requirement and contents).

46. In discussing why the Maine plant-closing statute “fails to implicate the regulatory concerns of ERISA itself,” *Fort Halifax*, 482 U.S. at 15, the Court considered *both* fiduciary responsibility and reporting and disclosure. The opinion observes that there was no “administrative activity potentially subject to employer abuse” and that “[n]o financial transactions take place that would be listed in an annual report, and no further information regarding the terms of the severance pay obligation is needed because the statute itself makes these terms clear.” *Id.* at 16.

47. ERISA §§ 3(1), (2), 29 U.S.C. §§ 1002(1), (2) (1994) (emphasis added).

48. *Id.*

49. See *Elmore v. Cone Mills Corp.*, 23 F.3d 855, 862 (4th Cir. 1994) (ruling an employer’s preliminary statements of its intentions concerning the terms of a new ESOP do not constitute an enforceable plan); *James v. National Bus. Sys., Inc.*, 924 F.2d 718, 720 (7th Cir. 1991) (Posner, J.) (stating that for ERISA to come into play the plan must be “intended to be in effect, and not just be something for future adoption,” and that documents describing a plan as being tentative, contingent, or *in futuro* should be considered as evidence that no plan was in effect).

*Donovan v. Dillingham*<sup>50</sup> is the leading authority on the proof required to demonstrate that a plan has been established.<sup>51</sup> The case involved the purchase of health insurance by small employers through a group insurance trust in order to obtain more favorable rates. The Secretary of Labor argued that even if the purchase of health insurance was not itself sufficient to trigger ERISA, the separate determination of each employer to provide benefits to its employees by subscribing to the group trust established a plan.<sup>52</sup> The Eleventh Circuit held that a plan is not “established” merely by virtue of a *decision* to provide benefits of a type specified in ERISA; rather, the program must have become a reality.<sup>53</sup> A decision implemented by the purchase of insurance, however, creates a plan.<sup>54</sup> Employers who purchased insurance through the group trust were found to have established ERISA welfare plans if the insurance was obtained to fulfill a collective bargaining agreement or under circumstances indicating an intent to provide continuing coverage of a class of employees.<sup>55</sup> More generally, the court observed that “[i]n determining whether a plan, fund, or program (pursuant to a writing or not) is a reality a court must determine whether from the surrounding circumstances a reasonable person could ascertain the intended benefits, beneficiaries, source of financing, and procedures for receiving benefits,” recognizing that some of these essential criteria can be incorporated from sources outside the plan, such as an insurance claims procedure.<sup>56</sup>

As the *Dillingham* definition suggests, no particular formality is required to show the existence of a plan. Most importantly, compliance with ERISA is not essential. (If compliance were a condition of plan classification, then ERISA’s standards, which were intended to be mandatory, would be made elective.)<sup>57</sup> Oral arrangements also can be plans even though ERISA requires

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50. 688 F.2d 1367 (11th Cir. 1982) (en banc).

51. “Every circuit that has since been required to decide whether, on the particular facts before it, a pension plan has come into being has adopted the *Dillingham* approach.” *Kenney v. Roland Parson Contracting Corp.*, 28 F.3d 1254, 1257 (D.C. Cir. 1994) (Ginsburg, J.) (citing authorities).

52. See 668 F.2d 1196, 1198 (11th Cir. 1982) (opinion before rehearing en banc).

53. *Dillingham*, 688 F.2d at 1373.

54. See *id.* at 1375.

55. *Id.* at 1374-75.

56. *Id.* at 1373.

57. See *id.* at 1372 (saying “it would be incongruous for persons establishing or maintaining informal or unwritten employee benefit plans, or assuming the responsibility of safeguarding plan assets, to circumvent the Act merely because an administrator or other fiduciary failed to satisfy reporting or fiduciary standards”); *Phillips v. Brandess Home Builders, Inc.*, No. 95-C-204, 1995 U.S. Dist. LEXIS 14496, at \*6 (N.D. Ill. Oct. 2, 1995) (“The applicability of ERISA standards cannot turn on an employer’s compliance with them.”); *Strzelecki v. Schwarz Paper Co.*, 824 F. Supp. 821, 826 (N.D. Ill. 1993) (“If an employer could avoid ERISA coverage of its benefit plan simply by violating ERISA’s requirements and then claiming that the plan did not function the way ERISA plans typically function, the whole purpose of the statute—to protect employees from employers’ mismanagement of

almost all welfare and pension plans to be in writing.<sup>58</sup> Similarly, unpublicized (secret) benefit programs can trigger the statute, bringing its fundamental tenet of employee disclosure into play.<sup>59</sup> Moreover, if the intended benefits and beneficiaries are clear but the employer is silent regarding funding or claims procedures, some decisions have found a plan based on the inference that benefits are to be paid out of the employer's general funds or that application for benefits should be made to the company's personnel department.<sup>60</sup>

Can an informal policy of providing a benefit in individually-determined amounts to selected employees be a plan? Arguably the intended benefits and beneficiaries of such a policy are unascertainable. When faced with evidence that a large employer maintained a longstanding system of ad hoc, individualized grants of severance benefits, the Third Circuit held that "the discretionary nature of benefits . . . does not alone deprive a document or program of its status as an employee benefit plan under the *Dillingham* standard, so long as a reasonable person can ascertain the contingent benefit and contingent beneficiaries."<sup>61</sup> The discretionary nature of the benefit would not prevent a disappointed employee from obtaining review of the denial of the benefit, but that review would be limited to the deferential abuse of discretion standard.<sup>62</sup> In contrast, the Seventh Circuit has refused to apply ERISA to an accounting firm's informal pension arrangement, where only three of twenty-five retirees received benefits and the amount was determined ad hoc rather than according to an established formula.<sup>63</sup> The court observed that "[w]ith only this evidence, we could not begin to fashion appropriate relief for [plaintiff], since we do not know whether he was the type of employee [the firm] intended to cover, or what benefits are due."<sup>64</sup> Similarly, a chief executive officer's practice of occasionally granting severance pay in amounts determined by the application of largely undefined

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benefit plans—would be defeated.") (citations omitted).

58. *E.g.*, *Dillingham*, 688 F.2d at 1372; *Scott v. Gulf Oil Co.*, 754 F.2d 1499, 1503-04 (9th Cir. 1985).

59. *See, e.g.*, *Brown v. Ampco-Pittsburgh Corp.*, 876 F.2d 546, 550-51 (6th Cir. 1989) (confidential memorandum to management created severance pay plan); *Blau v. Del Monte Corp.*, 748 F.2d 1348, 1356 (9th Cir. 1984), *cert. denied*, 474 U.S. 865 (1985) (same, and refusing to interpret secret plan with reference to the employer's secret intentions or past course of conduct).

60. *See, e.g.*, *Deibler v. United Food and Commercial Workers' Local Union 23*, 973 F.2d 206, 210 (3d Cir. 1992); *Dwyer v. Galen Hosp. Ill., Inc.*, No.94-C-544, 1996 U.S. Dist. LEXIS 2921, at \*26-27 (N.D. Ill. Mar. 11, 1996).

61. *Henglein v. Informal Plan for Plant Shutdown Benefits for Salaried Employees*, 974 F.2d 391, 401 (3d Cir. 1992).

62. *Id.*

63. *See Diak v. Dwyer, Costell & Knox, P.C.*, 33 F.3d 809, 813 (7th Cir. 1994).

64. *Id.* at 813.

criteria was found by a district court to be too unsystematic and indefinite to constitute a plan.<sup>65</sup>

The principle that discretionary authority brings ERISA's fiduciary standards into play to safeguard employees<sup>66</sup> clashes with these cases holding that too much discretion negates the existence of a plan by making the intended benefits or beneficiaries unascertainable. If standards or guidelines for the exercise of discretion can be gleaned from the employer's representations, past practice or surrounding circumstances, then the courts have a basis to review benefit determinations to prevent employer abuse, and the policy of ERISA demands that they do so.

But what if there are no standards, so that discretion is unbounded and benefits are awarded by a series of individualized ad hoc determinations? When discretion becomes prerogative, is there any role for a reviewing court to play? Under the federal Administrative Procedure Act there is no jurisdiction to review bureaucratic action where the decision is "committed by law to agency discretion."<sup>67</sup> The Supreme Court has interpreted this exception to the general rule of reviewability narrowly, holding that judicial review is precluded only where there is "no law to apply."<sup>68</sup> That is, preclusion applies only where there is no basis for a court to police the exercise of discretion because there is no indication of any standards or guidelines that the agency must use in making the decision. A similar futility concern seems to be at play in cases holding that too much discretion negates the existence of a plan by making the intended benefits or beneficiaries unascertainable. But such ready acceptance of the administrative law analogy may be inappropriate in the ERISA context. ERISA requires that every employee benefit plan "specify the basis on which payments are made to and from the plan."<sup>69</sup> "Plan" is a broader category than "fund," and this rule applies to nearly all plans, including unfunded welfare plans. Where there is no fund, specifying "the basis on which payments are made . . . from the plan" necessarily requires that the plan either expressly define its intended beneficiaries and benefits (either by specification, class description or formula), or set forth meaningful guidelines to inform the fiduciary's exercise of discretion.

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65. See *Spanos v. Continental Publ. Servs., Inc.*, No. C-93-1624 MHP, 1994 U.S. Dist. LEXIS 6695, at \*7-11 (N.D. Cal. May 17, 1994).

66. See *supra* text accompanying notes 31-40.

67. 5 U.S.C. § 701(a)(2) (1994).

68. *Citizens to Preserve Overton Park, Inc. v. Volpe*, 401 U.S. 402 (1971). See generally Ronald M. Levin, *Understanding Unreviewability in Administrative Law*, 74 MINN. L. REV. 689 (1990).

69. ERISA § 402(b)(4), 29 U.S.C. § 1102(b)(4) (1994).

Should a benefit arrangement that does not comply with this aspect of ERISA be exempt from ERISA, any more than (for instance) a program that violates the writing requirement? Because ERISA was designed to protect employees' reasonable expectations,<sup>70</sup> the answer should depend upon the information available to employees.<sup>71</sup> If the employer's acts or omissions created a reasonable expectation that benefits might be awarded, a plan should be held to exist, but covering only that group of employees for whom such a reasonable expectation could arise.<sup>72</sup> For example, ad hoc grants of severance or pension benefits that are unknown to the continuing workforce should not trigger ERISA. On the other hand, if workers become aware (whether by employer information or recurrent practice) that such benefits are granted to selected managerial employees, a plan covering management should be found to exist. Where no employer policy or past practice provides guidelines for selecting among contingent beneficiaries (management employees in this example) or setting benefit levels, a reviewing court should use reasonable expectations as a guide, resolving all doubts against the employer, whose unlawful conduct created the uncertainty.<sup>73</sup> This approach would distinguish *Henglein*, in which a plan was held to exist where the employer was aware that salaried employees believed there was an ongoing

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70. "[ERISA] was, at its core, a 'reasonable expectations' bill. It gave an ordinary employee the assured right to receive what a reasonable person in his boots would have expected in the circumstances. Primarily, it was a consumer protection bill." Frank Cummings, *ERISA: The Reasonable Expectations Bill*, 65 TAX NOTES 880, 881 (1994). ERISA's findings confirm that a major impetus for the legislation was the concern that many workers were "losing anticipated retirement benefits" due to the lack of vesting provisions and the termination of underfunded plans. See ERISA § 2(a), 29 U.S.C. § 1001(a) (1994).

71. This recommendation may seem inconsistent with decisions that hold unpublicized benefit programs to be plans subject to ERISA. See *supra* note 59 and accompanying text. Those cases, however, addressed situations where there was no uncertainty as to the employer's undertaking. Due to the secrecy there was no need to protect reliance (i.e., ERISA's protective policy was not implicated), but the statute's informational and anti-abuse objectives still loomed large. In the case of an unpublicized *indefinite* program, there is no reliance, nor is there much to be gained by way of worker career and financial planning or monitoring program administration.

72. *Belanger v. Wyman-Gordon Co.*, 71 F.3d 451 (1st Cir. 1995), held that severance pay granted under a series of four time-limited early retirement offers made within four years did not create an ongoing severance pay plan because each offer involved only an unfunded nondiscretionary one-time payment that was independent on its face, and the company never represented that there was any linkage or continuing commitment. See *id.* at 456. The court observed that in determining the existence of a plan "[o]ne very important consideration is whether, in light of all the surrounding facts and circumstances, a reasonable employee would perceive an ongoing commitment by the employer to provide employee benefits." *Id.* at 455.

73. If the court errs, the employer can respond by terminating the program. In the case of a welfare plan, termination can eliminate employer liability, except with respect to those participants who have previously satisfied all conditions for receipt of the benefit. In the case of a pension plan, termination prevents further benefit accrual, but it cannot eliminate participants' rights to benefits earned by prior service. ERISA § 204(g), 29 U.S.C. § 1054(g) (1994).



discretionary severance program but the employer made no effort to dispel that impression,<sup>74</sup> from *Diak*, in which the court held there was no plan, and where there was no evidence that the claimant was aware of ad hoc unfunded pension payments to three retirees.<sup>75</sup>

### 3. *Restricted Coverage*<sup>76</sup>

Restricted coverage constitutes the third ground on which the existence of a plan is frequently challenged. Where a benefit is provided to one or a very small number of employees the arrangement may be intended only as a “special deal” contained in individual employment contracts, and not part of a general program. But does the meaning of “plan” necessarily entail a general program? Attention to ERISA’s policies strongly suggests that the answer should be no.

Preliminarily, it should be noted that the statutory text offers scant guidance. The welfare and pension plan definitions refer in the plural to “participants” and “employees.”<sup>77</sup> On the other hand, in common usage the term “plan” normally conveys a sense of prearrangement or design, not generality.<sup>78</sup>

Legislative history suggests that a benefit arrangement covering one or a few employees can be a plan. ERISA’s reporting and disclosure rules and its definitions of welfare and pension plans are drawn from the Welfare and

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74. See *Henglein v. Informal Plan for Plant Shutdown Benefits for Salaried Employees*, 974 F.2d 391, 396, 400-02 (3d Cir. 1992) (describing relevant evidence of the existence of a plan, including the employer’s oral representations, “a deliberate failure to correct known perceptions of a plan’s existence, [and] the reasonable understanding of employees”).

75. See *Diak v. Dwyer, Costello, & Knox, P.C.*, 33 F.3d 809, 811, 813 (7th Cir. 1994) (observing that there was no evidence that claimant expected a pension; he was told that the firm had no pension plan and that payments to a retiree were compensation for services). In the author’s opinion, the *Diak* court reached the right result, but the decision should have been based on the lack of employee reliance rather than the difficulty in ascertaining the intended benefits or beneficiaries. Further, in *Gilmore v. Silgan Plastics Corp.*, 917 F.Supp. 685 (E.D. Mo. 1996), an announced company policy of granting severance benefits to employees approved by the plant manager was held not to create a plan, even though the manager’s discretionary decision was shown to have been based on production needs. Under the analysis suggested in the text the *Gilmore* facts are enough to constitute a plan. Had ERISA been applied the plaintiffs should nevertheless have been denied relief because they were not challenging any discretionary (i.e., fiduciary) decision. Instead, they had been denied benefits pursuant to company announcements (informal plan amendments) that clearly limited program eligibility to employees in other job classifications.

76. Parts of the following discussion are derived from Wiedenbeck, *supra* note 17, at 576-85.

77. See ERISA § 3(1), (2)(A), 29 U.S.C. § 1002(1), (2)(A) (1994). *But see* 1 U.S.C. § 1 (1994) (“In determining the meaning of any Act of Congress, unless the context indicates otherwise . . . words importing the plural include the singular”).

78. See, e.g., RANDOM HOUSE COLLEGE DICTIONARY 1014 (rev. ed. 1975); AMERICAN HERITAGE COLLEGE DICTIONARY 1045 (3d ed. 1993); WEBSTER’S NEW UNIVERSAL UNABRIDGED DICTIONARY 1372 (2d ed. rev. 1983).

Pension Plans Disclosure Act of 1958 ("WPPDA").<sup>79</sup> The WPPDA exempted plans covering twenty-five or fewer participants from disclosure obligations.<sup>80</sup> ERISA did not carry forward any such small plan exemption.<sup>81</sup> The alterations made to the predecessor definitions of welfare and pension plans are also telling. The WPPDA required that the plan be "communicated or its benefits described in writing to the employees."<sup>82</sup> This writing requirement was designed to "eliminate informal or personal arrangements from the scope of the [WPPDA]," because "[i]ndividual arrangements with executives for benefits are not contemplated as being covered by the [WPPDA]."<sup>83</sup> Under ERISA certain executive compensation arrangements are excluded in a more targeted fashion, as described below.<sup>84</sup> And while ERISA requires nearly all plans to be "established and maintained pursuant to a written instrument,"<sup>85</sup> the writing requirement is now a consequence of plan classification, not a predicate of it.<sup>86</sup>

A regulation in effect since 1975 indicates that a single-employee arrangement can be a plan subject to ERISA,<sup>87</sup> and several courts agree.<sup>88</sup> Other cases hold that restricted coverage bars ERISA's application, but many of them can be traced to some early ill-considered Labor Department advisory opinions that announced (without support) that an individual employment contract is not subject to ERISA<sup>89</sup>—a position the Department has since recanted.<sup>90</sup> These restrictive holdings may also proceed from the

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79. See WPPDA, *supra* note 20.

80. *Id.* § 4(b)(4).

81. Early versions of pension reform legislation did exempt plans covering not more than twenty-five employees. *E.g.*, Retirement Income Security for Employees Act, S. 4, § 104(b)(4) (1973), *reprinted in* 1 ERISA LEGISLATIVE HISTORY, *supra* note 13, at 117; S. REP. NO. 93-127, at 18-19 (1973) (stating small plans exempted to avoid inhibiting growth of pension coverage), *reprinted in* 1 ERISA LEGISLATIVE HISTORY, *supra* note 13, at 604-05.

82. WPPDA, *supra* note 20, § 3(a)(1), (2).

83. S. REP. NO. 85-1440, at 25-26 (1958), *reprinted in* U.S. DEPARTMENT OF LABOR, LEGISLATIVE HISTORY OF THE WELFARE AND PENSION PLANS DISCLOSURE ACT OF 1958 at 206 (1962) [hereinafter WPPDA LEGISLATIVE HISTORY]; *see also* H.R. REP. NO. 85-2283, at 11 (1958), *reprinted in* WPPDA LEGISLATIVE HISTORY, *supra*, at 207.

84. *See infra* text accompanying notes 91, 149-61.

85. ERISA §§ 401(a), 402(a)(1), 29 U.S.C. §§ 1101(a), 1102(a)(1) (1994).

86. *See supra* note 58 and accompanying text.

87. 29 C.F.R. §2510.3-3(b) (1997) ("[A] Keogh plan under which one or more common law employees, in addition to the self-employed individuals, are participants covered under the plan, will be covered under title I.").

88. *See, e.g.*, *Cvelbar v. CBI Ill., Inc.*, 106 F.3d 1368, 1376 (7th Cir. 1997), *cert. denied*, 118 S. Ct. 56 (1997); *Biggers v. Wittek*, 4 F.3d 291, 298 (4th Cir. 1993); *Williams v. Wright*, 927 F.2d 1540, 1545 (11th Cir. 1991); *Strzelecki v. Schwarz Paper Co.*, 824 F. Supp. 821, 827 (N.D. Ill. 1993).

89. *See, e.g.*, *Lackey v. Whitehall Corp.*, 704 F. Supp. 201 (D. Kan. 1988); *Jervis v. Elerding*, 504 F. Supp. 606, 607-08 (C.D. Cal. 1980); *O'Halloren v. Marine Cooks & Stewards Union*, 730 P.2d 616 (Or. Ct. App. 1986).

90. *See, e.g.*, Letter from Robert J. Doyle, Deputy Assistant Administrator for Regulations and

assumption that Congress could not have intended to work such a sweeping transformation of employment relations, for if applied to individualized benefit commitments, ERISA might seem to swallow up the common law of employment contracts. But this concern is misplaced, because ERISA only reaches post-employment compensation (i.e., pensions) and enumerated welfare benefits, not all terms and conditions of employment.

The objection that ERISA's protective policy is unnecessary when a benefit arrangement is specially designed (perhaps even separately bargained-for) to meet the needs of one or a few employees is more weighty. In those circumstances, it can be assumed that participation is fully informed and deliberate, and key personnel typically have the education, judgment, and bargaining power necessary to protect themselves. Because such special arrangements grow out of competition for highly-skilled labor, the firm's interest is aligned with the participant's, which minimizes the risk of employer abuse.

But restricted coverage by itself does not assure that the program is designed and administered to meet the needs of participants. Consider a financially strapped small firm that promises a pension to one or a few rank-and-file employees in lieu of paying higher wages. The business may fail while the benefit is unfunded, but the participants are not in a position to gauge that risk. As this example illustrates, the identity of the promisees is a better indicator of the need for regulation than mere breadth of coverage. In fact, ERISA excepts unfunded deferred compensation plans for "a select group of management or highly compensated employees" from its fiduciary oversight and pension content controls.<sup>91</sup> This targeted exclusion of certain executive compensation arrangements strongly confirms that an individual employment contract or small plan exception was not intended and is not necessary.

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Interpretations, Department of Labor, to Joel P. Bennett (Oct. 19, 1985), available in 1985 ERISA LEXIS 63 (saying ERISA coverage is "not affected by the fact that the arrangement is limited to covering a single employee, is negotiated between the employer and the employee, or is not intended by the employer-plan sponsor to be an employee benefit plan for purposes of [ERISA]"); ERISA Op. Ltr. 91-20A (July 2, 1991), available in 1991 ERISA LEXIS 29.

91. ERISA § 201(2), 29 U.S.C. § 1051(2) (1994) (participation, benefit accrual, vesting, spousal rights and anti-alienation); ERISA § 301(a)(3), 29 U.S.C. § 1081(a)(3) (1994) (funding); ERISA § 401(a)(1), 29 U.S.C. § 1101(a)(1) (1994) (fiduciary responsibility); ERISA § 4021(b)(6), 29 U.S.C. § 1321(b)(6) (1994) (termination insurance). This "top hat plan" exception is examined *infra* in Part II.D.

## B. "Employee" Status

### 1. Independent Contractors

ERISA applies only to plans that provide welfare or pension benefits to "employees,"<sup>92</sup> but the statute defines employee circularly, as "any individual employed by an employer."<sup>93</sup> In *Nationwide Mutual Insurance Co. v. Darden*,<sup>94</sup> the Supreme Court construed the term to incorporate the traditional test of employee status under the general common law of agency:

"In determining whether a hired party is an employee under the general common law of agency, we consider the hiring party's right to control the manner and means by which the product is accomplished. Among the other factors relevant to this inquiry are the skill required; the source of the instrumentalities and tools; the location of the work; the duration of the relationship between the parties; whether the hiring party has the right to assign additional projects to the hired party; the extent of the hired party's discretion over when and how long to work; the method of payment; the hired party's role in hiring and paying assistants; whether the work is part of the regular business of the hiring party; whether the hiring party is in business; the provision of employee benefits; and the tax treatment of the hired party."<sup>95</sup>

Conceding that the common law offers "no paradigm of determinacy,"<sup>96</sup> the Court explained that "all of the incidents of the relationship must be assessed and weighed with no one factor being decisive."<sup>97</sup> The Court rejected the argument that ERISA's broad remedial purposes support a more expansive reading of the term, in part because the purposive approach would engender even greater uncertainty.<sup>98</sup>

The burgeoning of the contingent workforce and the rise of

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92. A pension plan is defined as a program that provides retirement income to employees or results in a deferral of income by employees until the termination of employment or later. See ERISA § 3(2)(A), 29 U.S.C. § 1002(2)(A) (1994). In contrast, the welfare plan definition requires the provision of an enumerated benefit to "participants or their beneficiaries," but the term participant means any "employee or former employee . . . who is or may become eligible to receive a benefit" under the plan, or whose beneficiaries may be eligible. ERISA § 3(1), (7), 29 U.S.C. § 1002(1), (7) (1994).

93. ERISA § 3(6), 29 U.S.C. § 1002(6) (1994).

94. 503 U.S. 318 (1992).

95. *Id.* at 323-34 (quoting from *Community for Creative Non-Violence v. Reid*, 490 U.S. 730, 751-52 (1989)).

96. *Darden*, 503 U.S. at 327.

97. *Id.* at 324 (quoting from *NLRB v. United Ins. Co. of America*, 390 U.S. 254, 258 (1968)).

98. See *Darden*, 503 U.S. at 326-27.

telecommuting have made worker classification (employee versus independent contractor) increasingly important and contentious for employment tax purposes—fees paid to independent contractors are not subject to income tax withholding, social security taxes or the federal unemployment tax. Where a plan provides that it covers some or all categories of “employees” (meaning common law employees), or expressly excludes independent contractors, errors in worker classification can also cause wrongful denial of benefits.<sup>99</sup> But if the plan so provides, employees may be excluded from coverage based on their mode of payment, job type, work location, or other reason.<sup>100</sup> Consequently workers who are found to have been mistakenly treated as independent contractors are not automatically entitled to participate in employee benefit plans: worker classification is relevant to membership only if the plan makes it so.

## 2. Business Owners

The ERISA status of business owners continues to be problematic. Labor Department regulations provide that a benefit program that covers *only* individuals who own, or whose spouses own, an interest in an unincorporated business (as partner or proprietor) is not a “plan” subject to federal regulation, but ERISA does apply if one or more common law employees is a participant.<sup>101</sup> To avoid distortions in the choice of business form, if a corporation is *wholly* owned by an individual (or by an individual and his or her spouse), a benefit program that does not cover any other employee is also exempt from ERISA.<sup>102</sup> These limitations can make federal benefit protections turn on the sometimes difficult distinction between a common law employee and a service partner.

Recently, an appellate court held that a nominal partner in one of the world’s largest accounting firms was more properly classified as an

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99. *Vizcaino v. Microsoft Corp.*, 120 F.3d 1006 (9th Cir. 1997) (en banc) (holding that unless excluded by another provision, an ERISA plan that by its terms applies to “common law employees” must cover a large staff of “freelance” software developers that the company erroneously treated as independent contractors for employment tax purposes, despite the fact that freelancers were hired under the understanding that they were not eligible for benefits), *cert. denied*, 118 S. Ct. 899 (1998).

100. The only eligibility conditions outlawed by ERISA are certain age and service conditions in the case of pension plans and specified health status factors in the case of group health plans. *See* ERISA § 202, 29 U.S.C. § 1052 (1994); ERISA § 1182, 29 U.S.C.A. § 1182 (Supp. 1988).

101. 29 C.F.R. § 2510.3-3(b), (c) (1997). To trigger ERISA the program must cover a common law employee who is not an owner’s spouse.

102. *See id.* This rule applies even if the shareholder or spouse is also a common law employee of the corporation. It does not extend to cases where the corporation is closely held but not wholly owned by an individual or a married couple. Accordingly, the incorporation of a sole proprietorship does not affect ERISA’s coverage, but the incorporation of a partnership usually does.

employee for purposes of ERISA, and therefore entitled to statutory protection against discharge intended to prevent pension vesting.<sup>103</sup> While recognizing that the partner-employee distinction is governed by common law principles codified in the Uniform Partnership Act, the court's analysis was heavily influenced by the traditional test of employee status under the general common law of agency (as enunciated in *Darden*), with particular emphasis on the plaintiff's inability to participate in the management and control of the business.<sup>104</sup> The case presents an extreme example of a partner being frozen-out by a self-perpetuating management committee.<sup>105</sup> Yet the decision is startling because the federal income tax also relies on common law principles codified in the Uniform Partnership Act and reaches the opposite result: members of the largest accounting and law firms are taxed as partners regardless of the internal governance structure of the firm.<sup>106</sup>

ERISA applies if a benefit plan covers at least one common law employee along with business owners. But in that situation, do ERISA's protections extend to the owners? Only the regulation that defines the term employee benefit plan expressly excludes sole shareholders, sole proprietors, partners, and their spouses from the definition of employee.<sup>107</sup> Yet if there is a plan, ERISA grants rights and remedies to "participants" and their beneficiaries,<sup>108</sup> and the statute defines "participant" as an "employee or former employee of an employer . . . who is or may become eligible to receive a benefit" under the plan.<sup>109</sup> Reliance on the traditional common law understanding of the employment relation seems to compel the conclusion

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103. *Simpson v. Ernst & Young*, 100 F.3d 436 (6th Cir. 1996), *cert. denied*, 113 S. Ct. 1862 (1997).

104. *Simpson*, 100 F.3d at 443.

105. The district court opinion states this in its fuller recitation of facts. *See Simpson v. Ernest & Young*, 850 F. Supp. 648, 650-53 (S.D. Ohio 1994).

106. Although *Simpson* is admittedly a close case, in the author's opinion it was wrongly decided. The decision ignores the fact that partners may by agreement be completely excluded from management councils, downplays the probative value of loss sharing, and overlooks differences between a partner's and an employee's *apparent* authority to bind the firm when dealing with outsiders. *See* Uniform Partnership Act § 6(1) (1914) (partnership definition); *id.* § 7(4) (profit-sharing *prima facie* evidence of partnership); *id.* § 9(1) (apparent authority of partner); *id.* § 16(2) (effect of consent to representation as partner); *id.* § 18(e) (partner's management rights subject to modification by agreement).

107. *See* 29 C.F.R. § 2510.3-3(c) (1997) (exclusion from employee status "for purposes of this section"); *Madonia v. Blue Cross & Blue Shield of Va.*, 11 F.3d 444, 449-50 (4th Cir. 1993); Preamble, 40 Fed. Reg. 34,526, 34,528 (Aug. 15, 1975) (indicating the regulatory exclusion of sole shareholders, sole proprietors, partners, and spouses from the category of employees was deliberately restricted to the determination whether an employee benefit plan exists, and was not intended to govern interpretation of the term "participant").

108. *E.g.*, ERISA § 102, 29 U.S.C. § 1022 (1994) (disclosure); ERISA § 404(a)(1), 29 U.S.C. § 1104(a)(1) (1994) (fiduciary duties); ERISA § 502(a), 29 U.S.C. § 1132(a) (1994) (civil enforcement).

109. ERISA § 3(7), 29 U.S.C. § 1002(7) (1994).

that partners and proprietors cannot be participants and so cannot qualify for ERISA's protections, even if they are covered under a plan that includes common law employees. Accordingly, their rights and obligations would be defined and enforced by state, not federal, law.

In *Fugarino v. Hartford Life and Accident Insurance Co.*,<sup>110</sup> the Sixth Circuit concluded that the statute prescribes this result, that owner-participants do not have rights under ERISA. In *Fugarino*, the claims of a sole proprietor and his dependents under a group health insurance policy were judged under state law, while common law employees' rights were governed by ERISA.<sup>111</sup> Under such an approach the inclusion of a common law employee in a program established primarily for the benefit of the business owner does not expand or contract the owner's rights. But in *Madonia v. Blue Cross & Blue Shield of Virginia*,<sup>112</sup> the Fourth Circuit held that the claims of a sole shareholder and his dependents under a group health insurance policy are governed by ERISA, not state law, where corporate employees in addition to the shareholder were participants. *Madonia* expressly relied on the fact that under the separate entity principle of corporate law the shareholder was also a common law employee of his corporation. In his employee capacity the shareholder satisfied the definition of a participant as construed by the Supreme Court in *Darden*, while the plan was subject to ERISA because it covered employees in addition to the shareholder.<sup>113</sup> *Fugarino* is distinguishable because at common law an owner of an unincorporated business (sole proprietor or partner) cannot have the dual status of an employee, even if she provides services to the firm.

It seems strangely inefficient to have different bodies of law apply to employees and owners who work side by side in an unincorporated business and participate in the same benefit program. But although a single document sets forth the terms of the program, a careful reading of ERISA confirms that the "plan" subject to federal regulation is only that portion of the overall undertaking that serves common-law employees. The statutory definition provides that a welfare plan exists only "to the extent that such plan, fund, or program was established or is maintained for the purpose of providing [designated benefits] for its participants or their beneficiaries," and

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110. 969 F.2d 178 (6th Cir. 1992), cert. denied, 507 U.S. 966 (1993).

111. *Id.* at 185-87.

112. 11 F.3d 444 (4th Cir. 1993).

113. *Id.* at 448-50. Similar reasoning would indicate that, even though the rights of the partner or proprietor are given by state law, the spouse of a partner or proprietor would be protected by ERISA if that spouse was a participant employed in the business and the plan was subject to ERISA (i.e., some other employee was also a participant).

“participant” is defined with reference to employee status.<sup>114</sup> Similarly, a pension plan exists only “to the extent that by its express terms or as a result of surrounding circumstances such plan, fund, or program—(i) provides retirement income to employees, or (ii) results in a deferral of income by employees for periods extending to the termination of covered employment or beyond.”<sup>115</sup> Because the portion of a benefit arrangement that covers non-employees is not a plan, ERISA’s preemption of “any and all State laws insofar as they . . . relate to any employee benefit plan” does not apply: those non-employee participants are left to the care of state law.<sup>116</sup> At a policy level this limitation at least has the virtue noted earlier, that the benefit rights of the owner(s) of an unincorporated business are not altered by the inclusion of a common law employee in the program, even though federal law safeguards the employee’s interest.<sup>117</sup>

### C. The Dubious Pension-Welfare Dichotomy

ERISA applies only to an “employee benefit plan,” defined as either an employee welfare benefit plan or an employee pension benefit plan.<sup>118</sup> Consequently, in addition to requiring a “plan” in which at least one “employee” participates, federal regulation comes into play only if the arrangement provides either welfare or pension benefits. A program that provides retirement income or systematically defers compensation until termination of covered employment or beyond qualifies as a pension plan.<sup>119</sup> A program that provides any of certain *specifically-listed benefits* is a welfare plan, whether the benefit is provided on a current or deferred basis.<sup>120</sup> Welfare benefits may be provided in kind, but far more commonly they take the form of cash payments or reimbursements of the cost of designated expenses (e.g., medical care). Any non-pension employee benefit that is not enumerated in the definition of welfare plan is wholly exempt from federal regulation. This part will briefly examine some curious features of this statutory benefit taxonomy, beginning with pension benefits.

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114. ERISA § 3(1), (7), 29 U.S.C. § 1002(1), (7) (1994) (emphasis added).

115. ERISA § 3(2)(A), 29 U.S.C. § 1002(2)(A) (1994) (emphasis added).

116. ERISA § 514(a), 29 U.S.C. § 1144(a) (1994).

117. As the discussion of *Madonia* indicates, see *supra* text accompanying notes 112-13, if all of the stock of a corporation is owned by an individual (or by an individual and his or her spouse) the participation of some other employee may cause the stockholder’s or spouse’s rights to be determined under federal rather than state law.

118. ERISA §§ 4(a), 3(3), 29 U.S.C. §§ 1003(a), 1002(3) (1994).

119. ERISA § 3(2)(A), 29 U.S.C. § 1002(2)(A) (1994).

120. ERISA § 3(1), 29 U.S.C. § 1002(1) (1994).



### 1. Pension Benefits

Pension plans are subject to the most intense federal regulation because of the long-term nature of the benefit obligation and the resulting potential for changed circumstances and defeated expectations. Because the employee's circumstances may change, ERISA requires that pension benefits become nonforfeitable (vest) upon the completion of no more than seven years of service, and normally provides survivor annuity protection to the participant's spouse.<sup>121</sup> To protect against employer default, systematic advance funding is required of defined benefit plans and their benefits are insured by the PBGC.<sup>122</sup> Although deferral creates the risks to which these rules respond, the statutory definition of a pension plan is not simply keyed to the duration of the commitment. To be a pension plan the program must "provide retirement income to employees, or result[] in a deferral of income by employees for periods extending to the termination of covered employment or beyond."<sup>123</sup> Consequently, deferral of compensation, even for an extended period, does not create a pension plan (absent special circumstances) if the deferred amounts are payable during the continuance of the employment relation.<sup>124</sup> Indeed, such in-service deferred compensation arrangements do not even meet the definition of a welfare plan, and therefore are also exempt from federal disclosure and fiduciary obligations.<sup>125</sup>

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121. See ERISA §§ 203(a)(2), 205, 29 U.S.C. §§ 1053(a)(2), 1055 (1994).

122. See ERISA §§ 301-08, 4021-22, 29 U.S.C. §§ 1081-86, 1321-22 (1994)

123. ERISA § 3(2)(A), 29 U.S.C. § 1002(2)(A) (1994). ERISA is not a tax statute, and so the definitional references to "retirement income" and "deferral of income" should not be construed as conditioning pension plan classification on the time at which compensation is includible in gross income. Funded nonqualified deferred compensation is taxable upon the elimination of any substantial risk of forfeiture, I.R.C. §§ 83(a), 402(b) (1994), which may occur well in advance of retirement or separation from service, yet such plans were clearly intended to be subject to ERISA, see, e.g., ERISA § 201(2), 29 U.S.C. § 1051(2) (1994) (indicating only certain *unfunded* executive deferred compensation plans are subject to relaxed regulation). Hence the references to "income" in the pension plan definition should be interpreted according to the timing of the *distribution* of deferred compensation; in accordance, that is, with the common understanding that the term income has reference to receipt.

124. A Labor Department regulation provides that the term "pension plan" does not include "payments made by an employer to some or all of its employees as bonuses for work performed, unless such payments are systematically deferred to the termination of covered employment or beyond, or so as to provide retirement income to employees." 29 C.F.R. § 2510.3-2(c) (1997).

125. In-service deferred compensation may present a lower risk of abuse because the goodwill of current employees and the employer's reputation in the labor market are at stake, making the contract largely self-enforcing. A failing or downsizing firm, in contrast, may not be dissuaded by such concerns from taking advantage of departing workers. This is an example of the "last period problem," that market discipline becomes unreliable when one party expects to withdraw from continuing commercial intercourse, a situation which economists recognize as appropriate for legal intervention. See, e.g., FRANK H. EASTERBROOK & DANIEL R. FISCHER, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 95-96, 103, 169 (1991); ROBERT AXELROD, *THE EVOLUTION OF COOPERATION* 55-

Annuity distribution is not required for a plan to “provide[] retirement income.” A lump-sum payment can be used for support in retirement, and a plan that provides retirement income is a pension plan regardless of “the method of distributing benefits from the plan.”<sup>126</sup>

The other prong of the statutory definition is even more expansive, for a plan that defers income only to the “termination of covered employment”—that is, until separation from service—is a pension plan, although departing employees may be years away from retirement, in the sense of permanent withdrawal from the labor force. Moreover, a plan that does not “by its express terms” provide retirement income or defer compensation until separation from service is nevertheless a pension plan if it provides such payments “as a result of surrounding circumstances.” Under this rule a deferred compensation arrangement can be a pension plan if distributions are skewed toward the last years of participants’ careers,<sup>127</sup> and even relatively short-term deferral can trigger pension classification if the program’s coverage is tilted in favor of older workers nearing retirement.<sup>128</sup> Absent such surrounding circumstances, the mere fact that a fixed-term deferred compensation agreement calls for earlier payment in the event of death, disability or other termination of employment does not turn it into a pension plan because termination-based distributions are incidental, rather than being the focus of the program.<sup>129</sup>

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62 (1984); WILLIAM POUNDSTONE, PRISONER’S DILEMMA 228-30 (1993).

126. ERISA § 3(2)(A), 29 U.S.C. § 1002(2)(A) (1994) (final clause); ERISA Op. Ltr. 75-12 (July 17, 1975), *available in* 1975 ERISA LEXIS 55 (stating that a profit-sharing plan calling for lump-sum distribution on termination of employment is a pension plan under ERISA). A pair of Fourth Circuit decisions can be read as finding long-term payout important to pension classification, but the opinions are poorly reasoned and the suggestion is misguided, as fully explained in Wiedenbeck, *supra* note 17, 580-81 and nn.108-12.

127. *See* ERISA Op. Ltr. 83-46A (Sept. 8, 1983), *available in* 1983 ERISA LEXIS 14 (advising that late-career distributions and long payout schedule are factors to be considered in determining whether a deferred compensation arrangement is a pension plan as a result of surrounding circumstances).

128. *E.g.*, ERISA Op. Ltr. 89-07A (Apr. 17, 1989), *available in* 1989 ERISA LEXIS 1 (ruling a bonus program under which the employee must continue to be employed for five years to receive payment is not a pension plan unless the selection of bonus recipients is skewed toward employees nearing retirement); ERISA Op. Ltr. 81-16A (Jan. 23, 1981), *available in* 1981 ERISA LEXIS 75 (saying a 10-year payout could make oil and gas royalty fund a pension plan, depending on the likelihood that employees permitted to participate will retire or separate from service within that period).

129. *Hagel v. United Land Co.*, 759 F. Supp. 1199, 1202 (E.D. Va. 1991) (holding a bonus that provided for payment in five equal annual installments or earlier in the event of death, permanent disability or change in control of employer was not a pension plan because ERISA requires that a plan “generally defer the receipt of income to the termination of employment,” a requirement not satisfied where “under the facts of a particular case, a portion of the withheld income happens to become due after termination”); ERISA Op. Ltr. 83-46A (Sept. 8, 1983), *available in* 1983 ERISA LEXIS 14 (saying the “mere fact that a plan provides that payments which would otherwise be made on a

If a participant is given the option between taking payment of deferred compensation after a specified period of time and allowing the amount to remain on deposit for distribution (with earnings) upon separation from service, is it a pension plan? Provided that early payment is not penalized nor delayed distribution subsidized (by the tax law or the employer) so as to bias the participant's choice, the program would not cause compensation to be *systematically* deferred until the termination of employment, and is exempt from ERISA.<sup>130</sup> If, however, the employer administers the program in a way that discourages participants from taking early payment, then it is a pension plan as a result of surrounding circumstances. These circumstances may include the employer's communications (or lack thereof) concerning the program, such as the failure to publicize the early withdrawal option.<sup>131</sup>

Severance pay plans present a unique classification challenge under ERISA. Severance pay is, by definition, compensation deferred until the termination of employment. Thus it would automatically fall into the pension category but for a special dispensation. That dispensation takes the form of statutory authorization for the Secretary of Labor to write regulations treating some or all severance pay arrangements as welfare plans rather than pension plans.<sup>132</sup> Pursuant to that authority, a regulation has been promulgated which states that a severance program will not be treated as a pension plan if severance payments not exceeding twice the employee's annual pretermination compensation are completed within two years, and the

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specified date may be paid earlier in the event an employee terminates employment does not automatically mean that the arrangement is a pension plan by its express terms," but such accelerated payment is a factor to be considered in conjunction with surrounding circumstances); *see* *Murphy v. Inexo Oil Co.*, 611 F.2d 570 (5th Cir. 1980).

130. *See* 29 C.F.R. § 2510.3-2(c) (1997) (stating a bonus program does not constitute a pension plan unless "payments are systematically deferred to the termination of covered employment or beyond, or so as to provide retirement income to employees"); *McKinsey v. Sentry Ins.*, 986 F.2d 401, 406 (10th Cir. 1993).

131. *E.g.*, ERISA Op. Ltr. 81-18A (Feb. 2, 1981), *available in* 1981 ERISA LEXIS 73 (advising that an employee stock purchase plan under which participants had the right to sell their stock but were not always given share certificates could be a pension plan if it is administered or communicated in a way that discourages participants from receiving or selling the stock); ERISA Op. Ltr. 90-17A (June 25, 1990), *available in* 1990 ERISA LEXIS 27 (saying an employee stock purchase plan could be pension plan if communications to participants suggest that it is intended to provide retirement income or defer income until separation from service); ERISA Op. Ltr. 83-46A (Sept. 8, 1983), *available in* 1983 ERISA LEXIS 14 (same).

132. ERISA § 3(2)(B), 29 U.S.C. § 1002(2)(B) (1994). Severance pay is also a welfare benefit by virtue of the cross reference in ERISA's definition of a welfare plan to benefits described in § 302(c) of the Labor Management Relations Act. *See* ERISA § 3(1), 29 U.S.C. § 1002(1) (1994); 29 C.F.R. § 2510.3-1(a)(2) (1997). But recall that ad hoc separation payments to selected employees may be so indefinite that the arrangement does not constitute a "plan." *See supra* notes 48-75 and accompanying text.

payments are not conditioned, directly or indirectly, on retirement.<sup>133</sup> The Labor Department has taken the position that severance pay may be indirectly conditioned on retirement and so subject to stringent pension plan regulation if the program is limited to employees with many years of service (a group for whom termination of employment is likely to mean withdrawal from the labor force, i.e., retirement) or is conditioned on taking distribution from the company's retirement plan.<sup>134</sup>

## 2. Welfare Benefits

Welfare plans are subject to reporting and disclosure requirements, fiduciary responsibility standards, and a federal enforcement mechanism that includes broad preemption of state law. To be classified as a welfare plan the program must provide one or more statutorily enumerated benefits, namely:

(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 (other than pensions on retirement or death, and insurance to provide such pensions).<sup>135</sup>

In general, ERISA applies without regard to whether benefits are financed by the purchase of insurance (group-term life insurance is commonly used to provide employee death benefits, for example) or are paid out of the general assets of the employer (i.e., self-insurance). While a welfare plan may provide benefits of more than one type, a benefit that is not described in ERISA does not become subject to federal regulation merely because it is included with pension or welfare benefits in a multi-benefit plan.<sup>136</sup> Federal preemption does not apply, and employees' rights in such non-ERISA benefits are determined by state courts under state law.

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133. 29 C.F.R. § 2510.3-2(b) (1997).

134. *E.g.*, ERISA Op. Ltr. 84-15A (Mar. 20, 1984), available in 1984 ERISA LEXIS 32 (severance arrangement limited to employees with 18 or more years of service); ERISA Op. Ltr. 83-47A (Sept. 13, 1983), available in 1983 ERISA LEXIS 13 (severance pay conditioned on employee taking lump sum distribution from defined benefit pension plan).

135. ERISA § 3(1), 29 U.S.C. § 1002(1) (1994).

136. ERISA § 3(1), 29 U.S.C. § 1002(1) (1994), provides that a benefit program is a welfare plan only "to the extent that" it provides one of the statutorily-listed benefits. *Accord*, *Kemp v. IBM Corp.*, 109 F.3d 708, 713 (11th Cir. 1997).

The benefit types included in the welfare plan definition seem haphazard and unsystematic. In fact, the statute reflects the scope of two earlier pieces of federal legislation. ERISA's reporting and disclosure regime is traceable to the WPPDA. The WPPDA also provided the starting point for ERISA's definition of a welfare plan, but it reached only "medical, surgical, or hospital care or benefits, or benefits in the event of sickness, accident, disability, death or unemployment."<sup>137</sup> Presumably, this definition responded to the perceived prevalence of various sorts of employee benefit programs at the time of its enactment.

ERISA expanded upon the WPPDA's definition by directly listing most of the benefits then described in paragraphs (6) through (8) of section 302(c) of the Labor Management Relations Act (the Taft-Hartley Act), while incorporating the rest by reference.<sup>138</sup> In 1974, when ERISA was enacted, the cross reference to section 302(c) reached only severance and holiday benefits,<sup>139</sup> but a 1990 amendment of the Taft-Hartley Act has brought "financial assistance for employee housing" within the ambit of ERISA welfare plan regulation.<sup>140</sup>

ERISA's reliance on the Taft-Hartley Act's list of benefits apparently stems from the fact that notorious abuses in the management of employee benefit funds created the impetus for ERISA's fiduciary standards, and those abuses involved trusts to provide benefits to unionized employees under the Taft-Hartley Act.<sup>141</sup> That act makes it a crime for an employer to contribute

137. WPPDA, *supra* note 20, § 3(a)(1).

138. Compare ERISA § 3(1), 29 U.S.C. § 1002(1) (1994), with 29 U.S.C. § 186(c)(6)-(8) (1994). Paragraph (6) describes "pooled vacation, holiday, severance or similar benefits [and the] costs of apprenticeship or other training programs," 29 U.S.C. § 186(c)(6) (1994); paragraph (7) includes "scholarships for the benefit of employees, their families, and dependents for study at educational institutions [and] child care centers for preschool and school age dependents of employees," *id.* § 186(c)(7); paragraph (8) covers "a trust fund established . . . for the purpose of defraying the costs of legal services for employees, their families, and dependents," *id.* § 186(c)(8).

139. See 29 C.F.R. § 2510.3-1(a)(3) (1997) (regulation adopted in 1975 observes that the Taft-Hartley Act cross reference expands ERISA's statutory list of welfare benefits only by adding holiday, severance and similar benefits). As noted earlier, severance programs can also be classified as pension plans because benefits are deferred until "the termination of covered employment." ERISA § 3(2)(A)(ii), 29 U.S.C. § 1002(2)(A)(ii) (1994). Nevertheless, most severance pay plans are subject only to welfare plan requirements because the Labor Department has exercised its authority to exempt designated severance pay plans from pension controls by regulation. See ERISA § 3(2)(B), 29 U.S.C. § 1002(2)(B) (1994); 29 C.F.R. § 2510.3-2(b) (1997). Under that regulation, if severance benefits do not exceed two years' pay and are fully distributed within two years pension plan treatment can be avoided, and almost all severance programs are written to conform to those conditions.

140. See 29 U.S.C. § 186(c)(7)(C) (1994) (including housing assistance on the Taft-Hartley list).

141. Federal fiduciary standards were an early, noncontroversial component of legislative proposals for benefit plan regulation. That consensus grew out of spectacular revelations in the mid-1960s of the diversion of more than \$4 million from the welfare funds of two small local unions to the unfettered command of the union boss. See SENATE COMM. ON GOVERNMENT OPERATIONS,

to a trust for unionized employees if the trust provides any type of benefit not specifically permitted by section 301(c), so the Taft-Hartley Act's list of permissible benefits may have been assumed to cover the field of lawful employee benefits. Unfortunately, there are two defects in this analysis. First, other types of benefits may be provided to unionized employees if they are not funded through a trust, and ERISA was intended to apply regardless of funding.<sup>142</sup> (Even if there is no pot of money to steal, ERISA makes a fiduciary's discretionary decisions subject to oversight.) Second, employers may unilaterally establish benefit plans (funded or unfunded) for their nonunionized workers, and these programs are not constrained by the Taft-Hartley Act's list of permissible benefits. Accordingly, if ERISA's definition of a welfare plan was intended to cover the universe of non-pension benefits—or even if it was meant to cover all *funded* non-pension benefits—its drafters were mistaken.

On top of these defects, the ERISA drafters made a mess of their attempt to incorporate Taft-Hartley Act benefits. The Taft-Hartley Act exempts contributions to certain types of union-established employee benefit trusts from its ban on employer payments to labor organizations, including trusts to provide child care centers. ERISA adopted a corresponding reference to “day care *centers*,” which has led the Labor Department to conclude that the welfare plan definition comprehends child care benefits only when the employer provides child care *in kind* (on-premises day care facilities, for example), not when the company provides financial assistance for employee-arranged child care.<sup>143</sup> Similarly, the welfare plan definition catches “scholarship *funds*” but misses unfunded employer promises to provide education benefits.<sup>144</sup>

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DIVERSION OF UNION WELFARE-PENSION FUNDS OF ALLIED TRADES COUNCIL AND TEAMSTERS LOCAL 815, S. REP. NO. 1348, 89th Cong., 2d Sess. (1966); *Diversion of Union Welfare-Pension Funds of Allied Trades Council and Teamsters Local 815: Hearings Before the Permanent Investigations Subcomm. of the Senate Comm. on Gov't Operations*, 89th Cong., 1st Sess. (1965).

142. See *supra* Part II.A. The fiduciary responsibility provisions (part 4, title I) contain an exception for unfunded executive deferred compensation plans, ERISA § 401(a)(1), 29 U.S.C. § 1101(a)(1) (1994) (discussed *infra* Part II.D), but not for unfunded welfare plans nor unfunded pension plans generally.

143. E.g., ERISA Op. Ltr. 93-25A (Sep. 13, 1993), available in 1993 ERISA LEXIS 26 (indicating a program to reimburse dependent care expenses is exempt where caregivers are selected by participants); ERISA Op. Ltr. 91-25A (July 2, 1991), available in 1991 ERISA LEXIS 25; ERISA Op. Ltr. 88-10A (Aug. 12, 1988), available in 1988 ERISA LEXIS 10. Such dependent care assistance programs allow employees to direct a portion of their wages or salary to be withheld and used for reimbursing eligible expenses on a tax-free basis if the requirements of I.R.C. § 129 (1994) are satisfied.

144. 29 C.F.R. § 2510.3-1(k) (1997) (indicating unfunded scholarship programs are exempt).

### 3. *Other Benefits*

While it is possible that ERISA's drafters meant to cover all important employee benefits, clearly they did not. The pension and welfare plan definitions fail to reach several types of compensation that can be significant to workers' career and financial planning, such as the decision whether to accept or continue employment, or the determination of the necessary amount of household saving. Or, from a paternalistic perspective, the statute fails to cover a number of benefits that can induce substantial reliance. In-service deferred compensation is among the most glaring omissions.<sup>145</sup> But employer financial assistance that is targeted to child care or college costs is also usually exempt, and until recently help with the costs of home ownership was too. Because such arrangements escape classification as pension or welfare plans, federal preemption does not apply. Consequently, this third category of employee benefits, while exempt from federal oversight, is a permissible subject of state and local regulation.

### 4. *Policy Considerations*

The benefits beyond ERISA's reach do not make a major contribution to total compensation costs. But even though items such as employer financial assistance for child care or college costs are not significant in the aggregate, where they are available they can be extremely important to individual participants. Child care and college costs are after all among the largest household expenditures. And in-service deferred compensation, which can be used to save for any purpose—including saving for college or the purchase of a home—is also unregulated.<sup>146</sup> Such programs present a prospect of ill-informed decisionmaking and defeated expectations that is at least as great as the risk posed by many of the benefit arrangements to which ERISA expressly applies. (Accidental death and dismemberment insurance, for example, or group legal service plans.) The exclusion of such programs thus seems anomalous in view of the objectives of federal benefit regulation—the importance of information to efficiently functioning labor and capital

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145. This observation applies only to plans that mandate in-service distribution after a relatively brief period of deferral. Plans that permit workers to delay distribution are likely, as a result of surrounding circumstances (such as the preferential tax treatment of qualified plans or employer encouragement), to lead to deferral to the termination of employment, thereby triggering pension classification. And even plans that require in-service distribution could be pension plans if the distributions are delayed so long that they occur late in an employee's career, shortly before retirement. See *supra* notes 127-31 and accompanying text.

146. See *supra* text accompanying notes 124, 135.

markets, the potential for fiduciary misconduct, and the need to prevent unwarranted reliance (paternalism) are all implicated. Nevertheless, the continued omission of such benefits from even the limited oversight applied to welfare plans may be justified by the need to preserve employer flexibility and contain costs. Congress remains committed to a voluntary employee benefits system and does not want to stifle innovative compensation arrangements—additional items can be added to the list of welfare benefits when experience shows that conduct controls are needed.<sup>147</sup>

Turning now to the benefits that *are* subject to federal regulation, ERISA's classification scheme is arguably dysfunctional. Pensions are subject to much stricter regulation than welfare plans, including minimum participation and vesting requirements, and, in the case of defined benefit plans, funding and termination insurance. Congress imposed these minimum standards for the content of the pension promise because the long-term nature of the employer's commitment creates serious risk of defeated expectations. Unlike current compensation, the executory nature of the pension contract means an employer is not called on to perform its side of the bargain for many years, and in the interim circumstances may change (e.g., employer insolvency) to prevent performance, however genuine the company's initial commitment may have been. This concern is valid with regard to pensions, but the same risk is present in any form of deferred compensation, whether it is in-service deferred compensation (which is untouched by federal law) or a promise of deferred welfare benefits (which is subject only to reporting and disclosure, fiduciary obligations and federal enforcement). Consider the most important case, plans providing retiree health care benefits. Because no vesting requirement applies, employers are generally free to terminate such programs at any time to stem escalating costs or for other reasons, regardless of an employee's length of service or level of need. Such results occur because the welfare plan definition looks only to the type of benefit and pays no heed to whether it is to be provided on a current or deferred basis. The objectives of the statute would be better served if, instead of tying the level of regulation to the purpose for which benefits are provided, vesting and other appropriate content controls were applied to any plan providing substantial deferred compensation regardless of form, including retiree health care coverage and college saving plans. (Of course, existing pension content

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147. From this perspective, the mystery of ERISA's welfare plan definition lies in its inclusion of certain fringe benefits that are infrequently offered and of relatively low cost, such as prepaid legal services. Such inclusion seems attributable to the drafters' reliance on the Taft-Hartley Act's list of permissible union-sponsored benefit funds, which was amended in 1973 to include legal service plans. Act of Aug. 15, 1973, Pub. L. No. 93-95, 87 Stat. 997 (1973).



controls would need to be tailored to the different objective of these programs.<sup>148</sup>) The current welfare plan regulatory regime, which oversees the conduct of the benefit plan but does not affect its content, would then be applied only to benefit programs that do not entail a substantial element of deferral (such as current health care or life insurance coverage).

#### *D. Exceptions*

A few benefit arrangements that fit the statutory definition of an employee benefit plan (either pension or welfare) are nevertheless excepted from most or all of ERISA's requirements. The most important exceptions are for unfunded executive deferred compensation arrangements (so-called "top hat" plans), and for plans sponsored by governmental or religious organizations.

##### *1. Top Hat Plans*

Top hat plans are 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>149</sup> Although they would otherwise be classified as pension plans (the deferral invariably extends to the termination of employment or beyond), top hat plans are exempt from all the minimum standards applied to pension plans, and are even excused from ERISA's generally applicable fiduciary obligations.<sup>150</sup> Consequently, only the reporting and disclosure rules, the enforcement mechanism, and preemption apply.<sup>151</sup> Of these, the reporting and disclosure obligations of top hat plans have been relaxed by regulation,<sup>152</sup> so ERISA's principal effect on

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148. For example, an extended period of service might be an acceptable condition of eligibility or vesting for retiree health insurance, even though such indenture is prohibited under pension plans. Yet health care protection for a surviving spouse is as important as is survivor annuity coverage under pension plans. In contrast, it would seem that in the case of college savings plans, survivor protection should run in favor of dependent minor children.

149. See ERISA § 201(2), 29 U.S.C. § 1051(2) (1994).

150. *Id.* (accrual, vesting, spousal rights, and anti-alienation); ERISA § 301(a)(3), 29 U.S.C. § 1081(a)(3) (1994) (funding); ERISA § 401(a)(1), 29 U.S.C. § 1101(a)(1) (1994) (fiduciary responsibility); ERISA § 4021(b)(6), 29 U.S.C. § 1321(b)(6) (1994) (plan termination insurance).

151. *Barrowclough v. Kidder, Peabody & Co.*, 752 F.2d 923, 929-31 (3d Cir. 1985) (limited application to top hat plans), *overruled as to an unrelated point by Pritzker v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 7 F.3d 1110 (3d Cir. 1993) (arbitrability of ERISA claims).

152. ERISA § 110, 29 U.S.C. § 1030 (1994), permits the Labor Department to prescribe an alternate method of compliance with the statutory reporting and disclosure obligations for any category of pension plans that meet certain criteria. Pursuant to that authority, the Labor Department allows an employer to satisfy its informational obligations by filing a single statement of the number of unfunded top hat plans it maintains and the number of employees in each, and providing plan documents to the

unfunded executive deferred compensation arrangements is to provide a mechanism for federal judicial enforcement of the *terms of the plan*, which (as a result of the ouster of state law) must be interpreted and applied according to *federal common law*.<sup>153</sup>

This pattern is consistent with ERISA's policies. Congress exempted top hat plans from ERISA's requirements because high-level executives have the bargaining power to negotiate particular terms and monitor their interest under the plan, and therefore do not need substantive protections (the minimum standards of pension plan content) or fiduciary obligations. Moreover, employer flexibility is particularly important in the case of executive compensation arrangements, which must be individually tailored to attract and retain key personnel. But if bargaining and informal oversight break down, executives must have access to judicial enforcement to vindicate their contractual rights, or the plan becomes an illusory promise.<sup>154</sup> Notice that these considerations apply with equal force to both *funded* deferred compensation and welfare plans for top executives, yet the top hat plan exception is inexplicably limited to unfunded deferred compensation.

The definition of a top hat plan leaves the scope of the exemption unclear. The plan must be unfunded and "maintained by an employer primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees."<sup>155</sup> But what does "primarily" modify? Does it refer to the type of benefits provided ("primarily . . . deferred compensation") or to the composition of participants ("primarily . . . management or highly compensated employees")? Early decisions and rulings seemed to follow the latter approach, looking to the percentage of employees covered by the plan and comparing their *average* pay with the rest of the workforce, so that the exemption could apply even if a few rank-and-file employees were covered by the plan.<sup>156</sup> In 1990, however, the Labor Department announced its view that "primarily" refers to the benefits provided under the plan and not to the participant composition,<sup>157</sup> so that the

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Department on request. 29 C.F.R. § 2520.104-23 (1997); see *Barrowclough*, 752 F.2d at 931-34 (discussing relaxed disclosure requirements).

153. *Barrowclough*, 752 F.2d at 935-37 (saying the federal enforcement mechanism and federal common law apply to a claim for breach of the plan's terms); *Kemmerer v. ICI Americas, Inc.*, 70 F.3d 281, 287 (3d Cir.) (saying "breach of contract principles, applied as a matter of federal common law, govern disputes arising out of [top hat] plan documents," and such plans should be "interpreted in keeping with the principles that govern unilateral contracts"), *cert. denied*, 116 U.S. 1826 (1995).

154. *Kemmerer*, 70 F.3d at 288; Wiedenbeck, *supra* note 17, at 581.

155. ERISA §§ 201(2), 301(a)(3), 401(a)(1), 29 U.S.C. §§ 1051(2), 1081(a)(3), 1101(a)(1) (1994).

156. *E.g.*, *Belka v. Rowe Furniture Corp.*, 571 F. Supp. 1249 (D. Md. 1983). See generally, Vincent Amoroso et al., *SERP Sponsors Beware*, 24 Pens. & Ben. Rep. (BNA) 1001 (1997).

157. ERISA Op. Ltr. 90-14A (May 8, 1990), available in 1990 ERISA LEXIS 12.

exemption may be lost if any participant is not a member of the "select group." More recent decisions seem to follow this approach,<sup>158</sup> which is more consonant with ERISA's informational and protective policies, although in mixed membership plans it may "safeguard" executives in ways that they do not need or want.<sup>159</sup>

In order to apply a rule that top hat status is lost if any member fails to qualify as a "management" or "highly compensated employee," those categories must be specified with precision. Yet the statute leaves both terms undefined. Some practitioners have assumed that satisfaction of the tax law's quantitative definition of the term "highly compensated employee" suffices for top hat status, but that definition serves other purposes.<sup>160</sup> The Labor Department's 1990 opinion seems to take the view that "the ability to affect or substantially influence, through negotiation or otherwise, the design and operation of their deferred compensation plan" provides a functional definition of "management or highly compensated employees," and recent cases follow that path.<sup>161</sup> Under this approach many plans that extend coverage to middle management ranks could be found to violate ERISA's substantive provisions, even though all participants satisfy the tax law's definition of highly compensated employee. That may be appropriate in light of ERISA's protective policy, but the functional approach requires a fact-intensive inquiry the outcome of which is far less predictable than bright-line criteria keyed to compensation level.

## 2. Government Plans

Government and church plans, both pension and welfare, are exempt from all of ERISA's requirements, including the reporting and disclosure and federal enforcement provisions.<sup>162</sup> (In addition, government and church

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158. *E.g.*, *Duggan v. Hobbs*, 99 F.3d 307, 312-13 (9th Cir. 1996) (holding an unfunded pension provided under an individually-negotiated severance agreement was an exempt top hat plan because the departing employee had sufficient clout to influence the design and operation of the plan); *Gallione v. Flaherty*, 70 F.3d 724, 726-28 (2d Cir. 1995) (finding a union plan covering full-time officers, who were responsible for setting policy and negotiating labor contracts, exempt because its coverage was limited to the upper-echelon of union management).

159. If the top hat plan exemption is forfeited due to the inclusion of rank-and-file employees, then ERISA's pension funding and vesting requirements would come into play, which (in the case of a nonqualified plan) would cause the participants to be taxed in advance of distribution. *See* I.R.C. §§ 402(b), 83(a) (1994).

160. I.R.C. § 414(q) (West Supp. 1996) (the definition of highly compensated employee for purposes of the coverage and amount nondiscrimination rules).

161. *See, e.g.*, *Duggan*, 99 F.3d 307; *Gallione*, 70 F.3d 724. *See generally* Vincent Amoroso et al., *supra* note 156.

162. An early version of the bill that became ERISA would have applied fiduciary responsibility,

pension plans are excused from compliance with the tax law counterparts of ERISA's minimum standards for pension plan content; they must, however, satisfy pre-ERISA vesting and nondiscrimination rules to be treated as qualified plans.<sup>163</sup>) Unlike the top hat plan exceptions, these exclusions are not conditioned on the plan being unfunded or limited to executives. This is unsurprising, for the absence of need for regulation was not the primary justification for excluding government and church plans from coverage.

In the case of government plans, some legislators thought that minimum vesting standards were less necessary because public sector pension plans typically contained more liberal vesting requirements than their private sector counterparts.<sup>164</sup> The ability of governmental employers to make good their pension promises by exercise of their taxing power was considered by some an adequate substitute for minimum funding and plan termination insurance.<sup>165</sup> That view, however, was by no means universal; Congress went so far as to mandate a study of the need for federal regulation of government plans.<sup>166</sup> The decisive factor was apparently political—a concern that the

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reporting and disclosure, and federal enforcement provisions to state and local government plans. H.R. 2, 93d Cong. §§ 101(a), 503(e) (as reported by the Education and Labor Committee Oct. 7, 1973); H.R. REP. NO. 93-533, at 9 (1973).

163. I.R.C. §§ 401(a) (final sentence), 411(e) (accrual and vesting), 410(c) (prohibited age and service conditions and coverage nondiscrimination), 412(h) (funding and pre-ERISA vesting requirement), 4975(g) (prohibited transaction excise taxes) (1994). An irrevocable election can be made to have the tax qualification requirements apply to a church plan with full force. *Id.* § 410(d).

Qualified plan status is primarily relevant to participants in *funded* government or church plans because absent qualification they will be taxed on their share of the employer's contributions when their rights become nonforfeitable, an event which may occur long before the receipt of distributions from the trust or annuity contract. *See id.* §§ 402(b), 83(a). Distributions would not be eligible for tax deferral through rollover to a qualified plan or individual retirement account. *Id.* § 402(c)(1)(A), (c)(8)(A). Because governmental and church organizations are tax exempt, suspending the deduction of contributions to a nonqualified plan (as § 404(a)(5) requires) has no force.

Deferred compensation arrangements that do not satisfy the relaxed qualification requirements for government plans may nonetheless receive special tax treatment (deferral of taxation until distribution) if they meet the standards set out in § 457, but that alternative is unavailable to churches and church-controlled organizations. *Id.* § 457(e)(13).

164. H.R. REP. NO. 93-533, at 43 (1973) (additional views of Rep. Erlenborn).

165. H.R. REP. NO. 93-807, at 91, 165 (1974) ("It has been argued that governmental plans should be exempt from the funding standards since the taxing power can be viewed as a practical substitute for these standards."); S. REP. NO. 93-383, 81 (1973) (saying the tax power is also an adequate substitute for plan termination insurance).

166. ERISA § 3031, 29 U.S.C. § 1231 (1994); H.R. REP. NO. 93-807, at 91, 165 (1974) (proposing a study of governmental plans because the Ways and Means Committee was "concerned with reports that in the case of a number of governmental units, such generous pension promises have been made and so little funds have been set aside currently, that the practical likelihood of imposing sufficient taxes to pay those benefits may be open to question."); H.R. REP. NO. 93-533, at 43-44 (1973) (additional views of Rep. Erlenborn). The resulting study concluded that "[t]he absence of a coherent and uniform regulatory framework [for governmental plans] has resulted in generally ineffective communication of basic plan provisions, inadequate safeguarding of plan assets and

imposition of the new standards “might entail unacceptable cost implications to governmental entities.”<sup>167</sup> Or, from a more high-minded perspective, the governmental plan exception is founded on principles of federalism, in the sense of comity or non-interference, as opposed to constitutional imperative.<sup>168</sup>

A governmental plan is defined generally as a plan that is “established or maintained for its employees by the Government of the United States, by the government of any State or political subdivision thereof, or by any agency or instrumentality of any of the foregoing.”<sup>169</sup> The concept of an agency or instrumentality of a state or political subdivision is broad, but not limitless. The tax law’s definition of qualified deferred compensation plans contains corresponding exceptions for government and church plans, and the IRS has ruled that a volunteer fire company providing fire protection services by contract with local municipalities was not an agency or instrumentality of the government where the company was under the exclusive control of a board of trustees elected by the volunteer firefighters, was not affiliated with the state under any specific legislation, and was financed by community donations and contract fees rather than tax revenue.<sup>170</sup> The Service announced a multifactor test that emphasizes the extent of public control over the organization’s operations:

A plan will not be considered a governmental plan merely because the sponsoring organization has a relationship with a governmental unit or some quasi-governmental power. One of the most important factors to be considered in determining whether an organization is an agency or instrumentality of the United States or any state or political subdivision is the degree of control that the federal or state government has over the organization’s everyday operations. Other factors include: (1) whether there is specific legislation creating the organization; (2) the source of funds for the organization; (3) the manner in which the organization’s trustees or operating board are

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insufficient protection of participants’ interests.” HOUSE COMM. ON EDUCATION AND LABOR, 95TH CONG., 2D SESS., PENSION TASK FORCE REPORT ON PUBLIC EMPLOYEE RETIREMENT SYSTEMS 3 (Comm. Print 1978).

167. H.R. REP. NO. 93-807, at 165 (1974).

168. *Rose v. Long Island R.R. Pension Plan*, 828 F.2d 910, 914 (2d Cir. 1987); *see* H.R. REP. NO. 93-533 at 9 (1973).

169. ERISA § 3(32), 29 U.S.C. § 1002(32) (1994).

170. Rev. Rul. 89-49, 1989-1 C.B. 117. The Code’s definition of a governmental plan is identical to ERISA’s except that it requires the plan to be “established and maintained” by a governmental organization rather than “established or maintained.” *Compare* I.R.C. § 414(d) (1994), *with* ERISA § 3(32), 29 U.S.C. § 1002(32) (1994). This unexplained and apparently inadvertent discrepancy is discussed in *Rose*, 828 F.2d at 918-21.

selected; and (4) whether the applicable governmental unit considers the employees of the organization to be employees of the applicable governmental unit. Although all of the above factors are considered in determining whether an organization is an agency of a government, the mere satisfaction of one or all of the factors is not necessarily determinative.<sup>171</sup>

Although the Department of Labor has not adopted this test as an interpretation of ERISA's definition of a governmental plan, it appears to follow a similar approach.<sup>172</sup>

While the test focuses on operational control over the plan sponsor, day-to-day operational control *over the plan* is not required. A plan can be "established or maintained" by a unit of government for its employees without being governmentally administered—a health care plan for state employees is a government plan even though benefits are provided via contractual arrangements with one or more health maintenance organizations, for example.<sup>173</sup> Similarly, welfare and pension plans established by collective bargaining between a governmental unit and a union representing public employees are treated as established or maintained by the government even if they are administered by a board that is not controlled by the public employer; the exemption is not limited to plans created by the unilateral action of a governmental body.<sup>174</sup>

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171. Rev. Rul. 89-49, 1989-1 C.B. 117. Contrast Priv. Ltr. Rul. 9414007 (Dec. 16, 1993), which applied the same standards to find that a volunteer fire protection district created under specific state legislation was an instrumentality of state government where the bulk of its revenues was received from property taxes and three of the seven members of the district's board of trustees were elected by property owners or appointed by public officials.

172. See, e.g., ERISA Op. Ltr. 86-06A (Feb. 3, 1986), available in 1986 ERISA LEXIS 20 (indicating the City of Milwaukee Firemen's Relief Association's death benefit plan is a governmental plan because the association was established by state statute and municipal charter, its membership is limited to current and former public employees, and the plan is subsidized by the city).

173. *Silvera v. Mutual Life Ins. Co. of N.Y.*, 884 F.2d 423 (9th Cir. 1989); *Simac v. Health Alliance Med. Plans, Inc.*, 961 F. Supp 216 (C.D. Ill. 1997). Limiting the governmental plan exemption to cases of direct public administration of employee benefit plans would violate the principle of economic neutrality for no apparent purpose. Private employers cannot escape ERISA by contracting out the provision of benefits. See 29 C.F.R. § 2510.3-1(j) (1997) (saying employers may establish or maintain a benefit plan by paying premiums to provide coverage under group insurance arrangements selected by the employees).

174. ERISA Op. Ltr. 79-36A (June 11, 1979), available in 1979 ERISA LEXIS 56 (equal numbers of employer and union trustees); ERISA Op. Ltr. 86-22A (Sept. 9, 1986), available in 1986 ERISA LEXIS 7 (governmental plan even if administered solely by union representatives).

### 3. Church Plans

ERISA also exempts church plans, apparently out of concern for separation of church and state. The exception precludes First Amendment challenges based on entangling government regulation. ERISA accommodates the complex institutional structure of some churches by including as a church any related tax-exempt organization (trust or corporation). That organization need not have a primary religious purpose, however, so the church plan definition is astonishingly expansive. As amended in 1980, it goes far beyond exempting plans covering religious personnel or church employees, exempting plans covering employees of religiously-affiliated charitable organizations such as hospitals, schools, and group homes.<sup>175</sup> An employee of a tax-exempt organization is treated as the employee of a church and his employer is deemed to be a church if the organization is “controlled by or associated with a church or a convention or association of churches,”<sup>176</sup> and sharing “common religious bonds and convictions with the church” is sufficient to show association.<sup>177</sup> Accordingly, benefit plans covering employees of Catholic hospitals or parochial schools (for instance) may be exempt from ERISA, even though their tax-exempt but non-sectarian counterparts must contend with the full force of federal regulation.<sup>178</sup>

The church plan definition is expansive in two further respects. First, all ministers or clergy engaged in religious work are treated as church employees even if they are technically independent contractors or are

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175. The legislative history of the 1980 amendment is quite limited. See 126 CONG. REC. 20,180 (1980) (Sen. Javits remarks that exemption of church-related institutions was an undesirable but necessary political trade-off); *id.* at 20,208 (joint explanation of Senate bill, in the nature of a committee report); *id.* at 20,245 (clarifying remarks of Senators Talmadge and Long).

176. ERISA § 3(33)(C)(ii)(II), (33)(C)(iii), 29 U.S.C. § 1002(33)(C)(ii)(II), (33)(C)(iii) (1994); I.R.C. § 414(e)(3)(B)(ii), (e)(3)(C) (1994).

177. ERISA § 3(33)(C)(iv), 29 U.S.C. § 1002(33)(C)(iv) (1994); I.R.C. § 414(e)(3)(D) (1994).

178. See, e.g., ERISA Op. Ltr. 86-03A (Jan. 13, 1986), available in 1986 ERISA LEXIS 25 (plan covering Catholic school employees); ERISA Op. Ltr. 94-11A (Mar. 23, 1994), available in 1994 ERISA LEXIS 14 (plan covering employees of Mennonite hospital). Where the plan is set up by the church-related charity for its employees, the expansive definitions of “church” and “church employee” seem to assure that the plan is “established and maintained” by a (deemed) church for its employees. But church control or influence (direct or indirect) over the board or committee that administers the plan also satisfies the definition. ERISA § 3(33)(C)(i), 29 U.S.C. § 1002(33)(C)(i) (1994); I.R.C. § 414(e)(3)(A) (1994). Some rulings explicitly treat the latter requirement as an alternative means of satisfying the church plan definition. E.g., ERISA Op. Ltr. 95-10A (June 16, 1995), available in 1995 ERISA LEXIS 13 (plans for employees of Jesuit university). However, rulings under the corresponding tax law definition seem to suggest that church control over plan administration may be an additional, independent requirement. See Priv. Ltr. Rul. 9411045 (Dec. 22, 1993) (Catholic hospital plans satisfy tax Code’s definition of church plan).

actually employed by another institution (e.g., army, prison or hospital chaplains, or teachers of religious studies at an unrelated university).<sup>179</sup> Second, a retroactive correction mechanism is provided for plans that fail to meet the exemption criteria.<sup>180</sup>

### III. CONCLUSION

The scope of federal benefit regulation is remarkably broad—it can reach an oral promise made to a single employee. Yet ERISA's coverage also has some significant limitations. Some of those limitations are consistent with the statute's objectives; others are quite anomalous.

It takes a "plan" to trigger the statute. The goal of preventing mismanagement and abuse requires the oversight of discretionary decisionmaking, and so the courts have rightly concluded that the presence of discretion is sufficient to justify finding a plan exists. Stringent fiduciary obligations were also meant to apply to anyone who handles benefit funds, and so advance funding should be enough to find a plan, even absent discretion. In contrast, an unfunded nondiscretionary benefit obligation does not require fiduciary oversight, but in that case another statutory goal may justify imposing ERISA regulations. ERISA promotes economic efficiency by providing workers with the information they need to make better career and financial planning decisions. Where disclosure of the principal features of an ongoing benefit commitment would facilitate planning, that alone should be enough to find a plan.

Uncertainty as to the amount of benefits or the identity of beneficiaries has also led some courts to hold that no enforceable plan exists. Often that is the right result. But ERISA was intended to protect employees' reasonable expectations, so if the employer's acts create a reasonable expectation of benefits, that expectation should be enforced notwithstanding documents or practices that purport to give the employer uncontrolled discretion over who will benefit or in what amount.

ERISA was enacted to inform and protect employees. An "employee" must participate in a benefit program for the law to apply, which the Supreme Court construes to mean common law employee. But where business owners are covered under the same program as their common law employees, it is unsettled whether the owners' rights against insurers or third party administrators are controlled by federal or state law.

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179. ERISA § 3(33)(C)(ii)(I), 29 U.S.C. § 1002(33)(C)(ii)(I) (1994); I.R.C. § 414(e)(3)(B)(i) (1994); 126 CONG. REC. 20,245 (remarks of Sen. Long).

180. ERISA § 3(33)(D), 29 U.S.C. § 1002(33)(D) (1994); I.R.C. § 414(e)(4) (1994).



The applicability and intensity of federal regulation is also keyed to the nature of the program's benefits; only plans providing employees with "welfare" or "pension" benefits are covered. ERISA's goals would be best served by classifying deferred compensation of any sort as a pension benefit, with benefits provided currently designated as welfare benefits if they are important enough to warrant federal oversight. The history of political and legal attention to employee benefits, however, produced the less functional categories by which ERISA now operates. Pension controls come into play only if compensation is deferred to the termination of employment, welfare plans may offer substantial deferred compensation without concern for vesting or funding, and some important fringe benefits, including employer financial assistance with child care or college costs, are exempt from ERISA.

Three important exceptions from ERISA are also surprising in the light of the legislative objectives. Unfunded executive deferred compensation arrangements must use ERISA's enforcement mechanism, but are otherwise exempt from all federal and state regulation. Top managers clearly have access to information and the power to protect themselves, but why limit this exception to unfunded deferred compensation? Top executives hardly need fiduciary protections when they grant themselves special life insurance or health care coverage, or negotiate a special trust fund for their retirement. In addition, government and church plans, both pension and welfare, are entirely excluded from ERISA, regardless of the employees' need for information or protection. Although the legal rationales and political expediency of those exclusions are clear, many workers are left without protection, and in some industries ERISA's coverage is quite erratic. For example, both state and church-affiliated institutions of higher education are exempt, while private nonsectarian colleges and universities must toe the line.

Any comprehensive new statute is bound to contain some mistakes and political compromises. ERISA has its share. This analysis has shown that ERISA's coverage, while not capricious, is in several instances quite curious.