Are You Sure It’s ERISA?

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Imagine you are faced with a claim based on an alleged disabling condition that prevents an individual from working. You have a document from the employer that describes short-term disability benefits that the individual may be entitled to receive while unable to work. The document looks like a summary plan description and refers to the program as an employee benefit plan under the ERISA statutes. The employer files a Form 5550 annually with the Department of Labor and the IRS identifying it as an ERISA plan. It looks like ERISA, it sounds like ERISA, but is it really ERISA? Or is it in fact something else?

Attorneys handling ERISA claims should be aware that certain self-funded short-term payroll plans can appear remarkably, and deceivingly, like ERISA welfare benefit plans. If, however, the claim at issue is actually a compensation dispute related to payroll practices involving the employer’s general assets as the source of payment, ERISA does not apply. In such cases, litigation in federal court is not an option, and state court claims, such as bad faith breach of contract, can come into play.

Courts have recognized that the “broadly worded” language of ERISA does not clearly delineate the statute’s coverage, which defines an “employee welfare benefit plan” as:

> any plan, fund, or program which…is…established or maintained by an employer…for the purpose of providing for its participants or their beneficiaries, through the purchase of insurance or otherwise, (A) medical, surgical, or hospital care or benefits, or benefits in the event of sickness, accident, disability, [or] death… 29 U.S.C. § 1002(1).

Massachusetts v. Morash, 109 S. Ct. 1668, 1672 (1989); *Cal. Div. of Labor Standards Enforcement v. Dillingham Constr., N.A., Inc.*, 117 S. Ct. 832, 837 (1997).

After ERISA was enacted, the Secretary of Labor, who is the official specifically charged with defining ERISA’s “accounting, technical and trade” terms, promulgated a regulation that excluded “payroll practice” plans from ERISA’s “employee welfare benefit plan” definition even though such plans are established by employers to provide medical, sickness and other benefits to employees, and appear to fall within ERISA’s scope. *See, Morash*, 109 S. Ct. at 1674; *Stern v. IBM Corp.*, 326 F.3d 1367, 1372-73 (11th Cir. 2003) (parties dealt with claims made under “a program [that] would clearly qualify as an ERISA plan but for its specific exemption by a reasonably justified regulation”); *McMahon v. Digital Equip. Corp.*, 162 F.3d 28, 36 (1st Cir. 1998) (“[N]ot all plans that fall within the literal definition in § 1002(1) are included within the scope of ERISA, [such as] certain enumerated ‘payroll practices …’”). The non-ERISA payroll practice plans cover situations relating to:

> Payment of an employee’s normal compensation, out of the employer’s general assets, on account of periods of time during which the employee is physically or mentally unable to perform his or her duties, or is otherwise absent for medical reasons…. 29 C.F.R. § 2510.3-1(b)(2).

According to the preamble to the regulation, such plans are exempt because, “although relating to benefits described in [section 3(1) of [ERISA]], [they] are more closely associated with normal wages or salary.” 40 Fed. Reg. 34526 (Aug. 15, 1975). *Bassiri v. Xerox Corp.*, 463 F.3d 927, 932 (9th Cir. 2006).

Whether a particular case involves an ERISA benefit plan or an exempt payroll practice is a question of fact that is determined by examining the surrounding facts and circumstances. *McMahon*, 162 F.3d at 36; *Langley v. Daimler Chrysler Corp.* 502 F.3d 475, 479 (6th Cir. 2007). To be exempt, a plan must meet the definition of payroll practice, including whether the plan pays an employee’s “normal compensation” as a benefit. The Department of Labor chose to define “normal compensation” broadly; even if a short-term plan provides benefits that are less than an employee’s full salary, it can be sufficient to constitute “normal compensation.” *See, e.g., Bassiri,* 463 F.3d at 930-33 & n. 2 (court, giving deference to Department of Labor opinion letters, concluded that Xerox’s disability plan providing 60 percent of employees’ usual salary provided “normal compensation” under regulation definition); Butler v. Bank of Am., No. 3:06-CV-262-B, 2008 WL 1848426, at *2-3 (N.D. Tex. April 21, 2008) (finding employer’s STD policy exempt from ERISA; payment of minimum of 75 percent of employee’s base salary out of company’s general assets sufficient to constitute “normal compensation”).

The source of the funding for temporary benefits is a critical fact focused on by the Labor Department. For example, as long as the plan is *funded* entirely by the employer’s general assets, the fact that they are paid from a third-party’s bank account is immaterial. *Bilheimer v. Fed Express Corp.*, No. 08-80420-CIV, 2009 WL 1324202, *3 (S.D. Fla. May 13, 2009); *Walsh v. Life Ins. Co. of N.A.*, No. 06-10845-GAO, 2007 WL 2343657, *5 (D. Mass. Aug. 15, 2007). If, however, a plan is partially funded by an insurance policy rather than the employer’s general assets, or an employer receives reimbursement for payments it makes from an outside source, it will likely be deemed an ERISA plan. *McMahon*, 162 F.2d at 37; *Butler*, 2008 WL 1848426, at *3.

Payments made by an employer pursuant to a short-term payroll practice must be made on account of periods of time during which the employee is “physically or mentally unable to perform his or her duties” to fall within the regulation, and can include short term vacation plans, disability plans, sickness or accident plans, and others.

The fact that a document describing a benefits program refers to the program as “non-ERISA,” or lacks an explanation of ERISA appeal rights, can be considered in the evaluation. The way a plan is actually implemented can be considered, including whether benefits are paid in the same manner as salaries, and whether benefits end if an employee is terminated:

> Xerox’s LTD Plan more closely resembles salary: The payments come in regular paychecks, in an amount tied to the employee’s salary and not to the variable performance of a fund. And, like salary, LTD Plan benefits end upon termination. *See Scott v. Gulf Oil Corp.*, 754 F.2d 1499, 1503 (9th Cir. 1985) (noting that payroll practices end upon termination); *see also* Department of Labor, Opinion 96-16A, 1996 ERISA LEXIS 28, at *6 (Aug. 27, 1996) (finding that disability plan was not a “payroll practice” because, *inter alia*, the payroll practices exception is “not intended to apply to arrangements that continue cash payments to individuals…after the individuals have ceased to be considered employees…..”). *Bassiri*, 463 F.3d at 932.

Finally, the actions of the employer establishing the plan do not control whether a plan is an ERISA plan or a non-ERISA payroll practice. “[M]ere labeling by a plan sponsor or administrator is not determinative on whether a plan is governed by ERISA.” *Langley*, 502 F.3d at 481. Indeed, a plan description document can contain citations to ERISA, include a description of the employee’s ERISA rights, be filed as an ERISA plan with the IRS and Labor Department, be administered by a third-party insurance company, and an employer can even tell its employees that ERISA

applies, but if the program meets the payroll practice regulatory definition and the facts so support, it will be regarded as a non-ERISA payroll practice, and not an ERISA benefit plan:

> The way in which an employer characterizes its plan may be one factor, among others, in determining ERISA coverage. Nevertheless, even if IBM has treated the Program as an ERISA plan with respect to government filings, its mere labeling of the plan should not determine whether ERISA applies. Allowing this could lead to a form of “regulation shopping.” Where, as here, an employer pays an employee’s normal compensation for periods of mental or physical disability entirely from its general assets, the program constitutes an exempted payroll practice under 29 C.F.R. § 2510.3-1(b) and not an ERISA plan.

Stern, 326 F.3d at 1374 (citations omitted); see also, *Carmouche v. MEMC Pasadena, Inc.*, No. 06-2074, 2008 WL 2838474, *12 n. 2 (S.D. Tex. July 21, 2008).

Ultimately, these specific short-term benefit plans are preempted from ERISA coverage because they fall outside the primary purposes of ERISA. Congress enacted ERISA to prohibit employers from mismanaging monies they accumulate to fund employee benefits, and also to prohibit them from failing to pay such benefits due to employees from the accumulated funds. Extensive reporting, disclosure, and fiduciary duty requirements are imposed on employers to ensure that benefit funds are not dissipated through poor management. The short-term plans at issue in the payroll practice regulation are not vulnerable to either of these dangers. They are occasional, temporary benefits paid from an employer’s general assets, so there is no benefit fund to abuse or mismanage, and no special risk of loss or nonpayment of funds. Accordingly, there is no need to impose the stringent ERISA requirements on employers with respect to such plans.

[1] *Chevron USA, Inc. v. Natural Resources Defense Counsel, Inc.*, 104 S. Ct. 2778 (1984), requires deference to an agency’s interpretation of a statute, unless the regulation conflicts with “the unambiguously expressed intent of Congress.” It should be noted that courts have rejected the argument that the payroll practice regulation conflicts with ERISA and is therefore superseded by the statute. No court has found that Congress expressed an unambiguous intent that ERISA should encompass self-funded short-term disability plans, so ERISA does not supersede or preempt the payroll practice regulation. *Monkhouse v. Stanley Associates, Inc. Short Term Disability Income Plan*, 2010 U.S. Dist. LEXIS 40555 (S.D. Tex. April 26, 2010).