ERISA PRE-EMPTION OF NEW YORK LABOR LAW RAISES NEW ISSUES CONCERNING EMPLOYER SEVERANCE PAY POLICIES

by Joseph DeGiuseppe, Jr.

Introduction

Section 198-c of the New York Labor Law[1] provides for criminal and other sanctions against employers who fail, neglect or refuse to pay "benefits or wage supplements" to employees within thirty days after such payments are required to be made. As defined by the New York statute, the phrase "benefits or wage supplements" includes reimbursements for expenses, health, welfare and retirement benefits, and vacation, separation or holiday pay.[2] In *Gilbert v. Burlington Industries, Inc.,*[3] the Second Circuit Court of Appeals, in dismissing plaintiffs' severance pay claims under New York law, held that the provisions of Section 198-c are pre-empted by the Employee Retirement Income Security Act of 1974 ("ERISA")[4] insofar as the State statute "relates to" severance pay "plans."

The United States Supreme Court's affirmance without opinion of *Gilbert,*[5] together with the related Fourth Circuit case of *Holland v. Burlington Industries, Inc.* (collectively, the "*Burlington* cases"),[6] confirms that unfunded severance pay policies may constitute "employee welfare benefit plans"[7] covered by ERISA and that state law "relating to" such severance plans is pre-empted by the federal statute. The Court's affirmance of the *Burlington* cases has not, however, resolved a number of other issues concerning the application of ERISA to severance pay policies. As demonstrated by recent case law, federal courts have consistently failed to delineate the appropriate criteria for determining whether an employer has in fact "established or maintained" an "employee welfare benefit plan" within the meaning of ERISA. The courts have also failed to set forth clear standards for determining whether plan participants were "arbitrarily and capriciously" denied severance benefits in corporate divestiture cases.

This article examines these recent cases and the issues that need to be resolved in analyzing the application of ERISA to severance pay policies.[8]

ERISA Welfare Plans

ERISA is a comprehensive remedial statute designed "to improve the equitable character and soundness of private employee benefits plans and to establish minimum standards of fidiciary conduct for those who administer such plans."[9] Employers who have benefit plans that are subject to ERISA must comply with the reporting and disclosure requirements[10] and the fiduciary responsibility standards of the statute.[11] Unlike pension plans, employee welfare benefit plans are not subject to ERISA's minimum funding and vesting provisions.[12] The federal statute does, however, provide a private right of action to plan participants to enforce their rights under either a pension or welfare benefit plan.[13]

Section 3(1) of ERISA[14] defines the terms "employee welfare benefit plan" and "welfare plan" to include:

> [A]ny plan, fund, or program which was heretofore or is hereafter established or maintained by an employer or by an employee organization, or by both, to the extent that such plan, fund, or program was established or is maintained 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, death or unemployment, or vacation benefits,. . . or (B) any benefit described in section 186(c) of this title (other than pensions on retirement

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or death, and insurance to provide such pensions).

The section 186(c) cited in subsection (B) of the foregoing definition refers to Section 302(c) of the Labor-Management Relations Act ("LMRA")[15] which concerns, in relevant part, money paid to trust funds "for the purpose of pooled vacation, holiday, severance or similar benefits . . ."[16] According to the regulations promulgated by the Department of Labor pursuant to ERISA, the effect of citing section 186(c) in the statutory definition of "employee welfare benefit plan" is "to include within [this] definition . . . those plans that provide holiday and severance benefits, and benefits which are similar. . . ."[17] In order to have the "establishment" of a plan, fund or program within the meaning of ERISA, "the surrounding circumstances must be such that 'a reasonable person can ascertain the intended benefits, a class of beneficiaries, the source of financing, and procedures for receiving benefits.' "[18] The absence of a formal written policy is not, in itself, determinative of whether an ERISA plan exists.[19]

ERISA Pre-emption

Section 514(a) of ERISA[20] contains an express pre-emption provision that provides, in pertinent part:

> Except as provided in subsection (b) of this section, the provisions of this subchapter and subchapter III of this chapter *shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan* described in section 1003(a) of this title and not exempt under section 1003(b) of this title. . . .[21]

In *Shaw v. Delta Air Lines*,[22] the Supreme Court held that the pre-emption language of Section 514(a) must be broadly defined as follows: "A law 'relates to' an employee benefit plan, in the normal sense of the phrase, if it has a connection with or reference to such a plan."[23] The *Shaw* Court rejected the view that state statutes or common law claims are pre-empted only when they attempt to regulate matters such as reporting, disclosure, or fiduciary responsibilities or any other areas expressly covered by ERISA.[24] In addition, the Supreme Court made clear in *Metropolitan Life Insurance Co. v. Massachusetts*[25] that "[t]he pre-emption provision was intended to displace all state laws that fall within its sphere, even including state laws that are consistent with ERISA's substantive requirements."[26]

Burlington Cases

In the *Burlington* cases,[27] plaintiffs brought suit against their former employer for severance pay on the grounds that their employment was "involuntarily terminated" within the meaning of the defendant's severance pay policy when the operating division for which they had been working was sold as a going concern to another company. The records on appeal in both *Gilbert* and *Holland* showed that the plaintiffs continued to do the same work for their new employer as they had done for the defendant prior to the sale.

In order to ensure that its employees would accept employment with the purchaser of the division, defendant agreed not to retain any employees who the purchaser wished to hire and not to rehire these individuals for a period of at least six months after the sale. In *Holland*, the record also showed that defendant had agreed to provide severance pay to any employee who was terminated by the purchaser within six months after the sale.

The severance pay policy upon which plaintiffs based their claims was fully set forth in a manual that was not distributed to employees. Under the express terms of the policy, employees were deemed to be eligible to receive "payroll severance" if they were "involuntarily terminated" for reasons including the "elimination or modification of operations or other job elimination due to bona fide organizational changes. . . ."[28] A summary description of this severance policy was contained in an employee handbook. Shortly before the sale of their division, the plaintiffs were informed by the defendant that they would not receive severance benefits whether or not they accepted a position with the purchaser.

Plaintiffs commenced suit against defendant alleging causes of action under state law or, in the alternative, under ERISA.[29] The New York State Commissioner of Labor intervened in *Gilbert* demanding that defendant pay severance benefits to plaintiffs in accordance with the provisions of Section 198-c of the New York Labor Law.

In both *Holland* and *Gilbert*, the district court held that the defendant's unfunded severance pay policy was an "employee welfare benefit plan" and that the plaintiffs' state law claims for severance pay were pre-empted by ERISA.[30] The district court in *Holland* also held that the defendant's decision to deny plaintiffs severance pay was neither arbitrary nor capricious within the meaning of ERISA, an issue not reached by the district court in *Gilbert*.[31]

On appeal, the Second Circuit affirmed the district court's holding that an unfunded serverance pay policy is an ERISA plan under either Section 3(1) (A) or (B) of the federal statute. The court apparently reached this conclusion without considering whether the "established or maintained" requirement of Section 3(1) had been satisfied by the facts of *Gilbert*. Instead, the Second Circuit concluded that severance pay, although "often a reward for past service,"[32] serves the same purpose as unemployment benefits and is therefore an "employee welfare benefit plan" under the Section 3(1)(A).

Relying on the federal regulations[33] and legislative history[34] to Section 3(1)(B), the *Gilbert* court concluded that a "reasonable construction" of this Section also encompassed unfunded severance pay plans in spite of the reference in Section 3(1)(B) to the Taft-Hartley trust language of Section 302(c) of the LMRA.[35] The Second Circuit again did not articulate whether the "established or maintained" requirement of ERISA had been satisfied or which facts of the case satisfied this requirement. The Fourth Circuit in *Holland* similarly concluded that an unfunded severance pay plan is an ERISA plan under the provisions of Section 3(1) without considering the issue of whether the defendant had in fact "established or maintained" such a plan.[36]

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The Pre-emption Issue

Citing the Supreme Court's decision in *Shaw v. Delta Air Lines*,[37] the Second and Fourth Circuits in the *Burlington* cases also confirmed that the plaintiffs' state law claims were pre-empted by ERISA. The Second Circuit rejected the plaintiffs' argument that "ERISA cannot be deemed to pre-empt state wage collection statutes because such legislation is a fundamental exercise of the states' police power."[38] In addition to representing an exercise of a traditional police power, the *Gilbert* court reasoned that, in order to avoid ERISA pre-emption, the statute "must also affect the plan in too tenuous, remote or peripheral a manner to warrant a finding that the law 'relates to' the plan."[39] The Second Circuit concluded that, although Section 198-c of the New York Labor Law was an exercise of a traditional police power, "the state statute does not have such a remote and tenuous connection to Burlington's severance pay plan so as to allow us to conclude that it does not 'relate to' it."[40]

The Fourth Circuit in *Holland* similarly concluded that the North Carolina Wage and Hour Act[41] was pre-empted by ERISA. Among the reasons cited by the *Holland* court for its decision was the need to ensure "uniformity in employer obligations" through the exercise of ERISA pre-emption. The *Gilbert* and *Holland* courts also held that plaintiffs' breach of contract and other common law claims were pre-empted by ERISA.

Arbitrary and Capricious Standard

The Fourth Circuit in *Holland* held that the defendant's denial of severance benefits to plaintiffs was not "arbitrary and capricious" within the meaning of ERISA. The *Holland* court rejected the plaintiffs' invitation to deviate from the Fourth Circuit's arbitrary and capricious standard[42] under the facts of this case, reasoning that "it is necessary to ensure that primary responsibility rests with administrators 'whose experience is daily and continual, not with judges whose exposure is eposodic and occasional,'. . . This objective holds true whenever consistent administration of a pension plan or welfare benefit plan covered by ERISA is at issue."[43] In addition, the Fourth Circuit distinguished the facts of *Holland* from those of *Blau v. Del Monte Corp.*[44] where the Ninth Circuit found that the "wholesale and flagrant" flouting of ERISA's procedural requirements by the employer in that case were factors to be considered in determining whether the denial of severance benefits after a corporate divestiture was "arbitrary and capricious."[45]

The Second Circuit in *Gilbert*, in considering whether defendant should be estopped from raising the defense of pre-emption because it had failed to comply with ERISA's reporting, disclosure and fiduciary requirements,[46] adopted the approach of *Blau* that under certain circumstances an employer's non-compliance with the procedural requirements of ERISA will work a "substantive harm" justifying a finding that the employer's denial of severance pay was arbitrary and capricious.[47] The *Gilbert* court reasoned that the *Blau* approach "both eliminates any incentive on the part of employers not to comply with the Act's reporting, disclosure and fiduciary requirements, and avoids inconsistent treatment of claims under state law."[48] The Second Circuit therefore remanded the "arbitrary and capricious" issue to the district court, finding it "unnecessary and undesirable to hold Burlington estopped from raising the defense of pre-emption."[49]

Recent Cases

Since the *Burlington* cases, most courts have failed to apply clearly defined criteria for determining whether a severance pay policy is in fact an ERISA plan and whether the denial of severance benefits after a corporate divestiture is "arbitrary and capricious" within the meaning of the statute. With respect to the first issue, courts have been willing to state those factors which do not disprove the existence of a severance pay plan under ERISA, but have failed to consider whether the "established or maintained" requirement of Section 3(1), as set forth in *Donovan v. Dillingham*,[50] was also satisfied.

In *Mylstar Electronics, Inc. v McNeil*,[51] for example, the district court, without referring to *Dillingham*, rejected the argument that lack of funding and failure to comply with ERISA's procedural requirements established that a severance pay policy was not an "employee welfare benefit plan" covered by the federal law. In *Molyneux v. Arthur Guinness and Sons, P.L.C.*,[52] however, the Southern District of New York utilized the *Dillingham* criteria in concluding that the defendant had not established a severance pay "plan" within the meaning of ERISA. Among the factors cited by the *Molyneux* court for determining whether or not ERISA plan has been "established" is the existence of claim procedures (written or unwritten), the identity of the employee group covered, and the method of financing or calculating benefits.[53] Other courts have not used this analysis in determining whether an ERISA severance pay plan had been "established or maintained."

The standards for determining whether the denial of severance benefits after a corporate divestiture is "arbitrary and capricious" under ERISA were summarized in *DeAngelis v. Warner Lambert Co.*,[54] by the Southern District of New York as follows: "(1) whether the challenged interpretation of the plan is fair and reasonable in the

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context of the entire plan; . . . (2) whether the challenged interpretation has been uniformly applied in similar situations; . . . (3) whether the grant of severance benefits would render a double recovery of benefits to the plan participants; . . . and (4) whether the plan administrator has violated ERISA's procedural requirements so consistently and flagrantly that a substantive harm has been worked on the plan participants. . . ."[55] The last factor was developed by the Ninth Circuit in *Blau v. Del Monte Corp.*[56] and has been viewed as requiring a higher level of statutory violation than those ordinarily required under the "arbitrary and capricious" standard.[57] Courts have recognized, however, that a fiduciary's failure to comply with ERISA's procedural requirements does not in itself entitle claimants to any substantive remedy.[58]

Despite the "arbitrary and capricious" standards summarized in *DeAngelis*, courts in recent cases have often only identified that conduct which is not in violation of the fiduciary responsibilities imposed by ERISA by merely distinguishing the facts of *Blau* from the facts of their decisions. The difficulties in ascertaining the appropriate standards for determining whether the denial of severance benefits after a corporate divestiture is "arbitrary and capicious" stem directly from the facts of *Blau* which do not appear to be materially different from those of other cases in which *Blau* has been readily distinguished.[59]

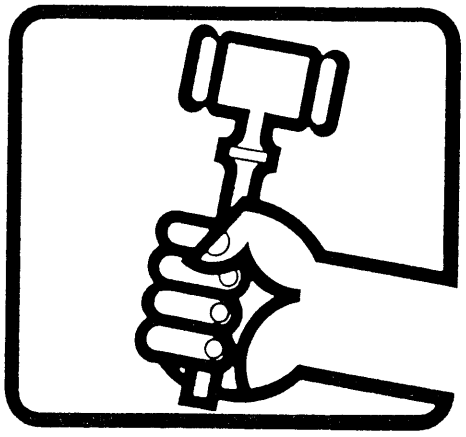
In *Blau*, the defendant concealed its severance pay plan from its employees, failed to create procedural mechanisms for benefit determinations, and "made no attempt to comply with any of the duties that ERISA places upon a benefit plan administrator."[60]

The defendant in *Blau* also failed to follow the standards of its severance pay policy by requiring actual unemployment rather than job elimination "from the Corporation" as a condition to the receipt of severance benefits after a corporate divestiture.[61]

Upon facts similar to *Blau*, courts have summarily dismissed severance pay claims in corporate divestiture cases involving alleged procedural and other ERISA violations, even where actual unemployment was not required by a severance pay plan for the receipt of benefits. In *DeAngelis v. Warner Lambert Co.*,[62] for example, the court held that there was no "arbitrary and capricious" conduct in the denial of severance benefits after a corporate divestiture, where procedural violations existed and where a "job elimination" provision was interpreted, as in *Blau*, to require actual loss of a position as a condition to the receipt of severance benefits.[63] Other courts in corporate divestiture cases have also not found an employer's procedural violations of ERISA sufficient to support claims for severance pay under the "arbitrary and capricious" standards where actual unemployment was deemed to be a plan requirement.[64]

Conclusion

The Supreme Court's affirmance without opinion of the *Burlington* cases has left unresolved critical issues regarding the criteria for determining whether a severance pay "plan" has been "established or maintained" within the meaning of ERISA and whether an employer's denial of severance benefits after a corporate divestiture is "arbitrary and capricious." In light of the significant amount of litigation that has been occurring with respect to claims for severance pay after corporate divestitures, the Court may soon have the opportunity to resolve these issues.[65]



Footnotes

1. N.Y. Lab. Law § 198-c (McKinney Supp. 1986).
2. *Id.* § 198-c(2).
3. 765 F.2d 320 (2d Cir. 1985), *aff'd*, 106 S. Ct. 3267 (1986) (mem.).
4. 29 U.S.C. §§ 1001-1461.
5. *See Roberts v. Burlington Industries, Inc.*, 106 S. Ct. 3267 (1986) (mem.); *Gilbert v. Burlington Industries, Inc.*, 106 S. Ct. 3267 (1986) (mem.).
6. 772 F.2d 1140 (4th Cir. 1985), *aff'd sub nom. Brooks v. Burlington Industries, Inc.*, 106 S. Ct. 3267 (1986)(mem.).
7. 29 U.S.C. § 1002(1).
8. This article does not concern the issue of whether severance pay policies constitute pension plans within the meaning of ERISA. *See* 29 C.F.R. § 2510.3-2(b), with respect to this issue.
9. *DeAngelis v. Warner Lambert Co.*, 641 F. Supp. 467 (S.D.N.Y. 1986).
10. 29 U.S.C. §§ 1021-1031.
11. *Id.* §§ 1101-1114.
12. *Id.* §§ 1051(1), 1081(a) (1); *see Bruch v. Firestone Tire & Rubber Co.*, 640 F. Supp. 519 (E.D. Pa. 1986).
13. 29 U.S.C. § 1132(a)(3)(B)(ii).
14. *Id.* § 1002(1).
15. *Id.* § 186(c).
16. *Id.* § 186(c)(6).
17. 29 C.F.R. § 2510.3-1(a)(3).
18. *Molyneux v. Arthur Guinness & Sons, P.L.C.*, 616 F. Supp. 240, 243 (S.D.N.Y. 1985) (quoting *Donovan v. Dillingham*, 688 F.2d 1367, 1373 (11th Cir. 1982) (en banc)).
19. *Molyneux v. Arthur Guinness & Sons, P.L.C.*, 616 F. Supp. 240, 243 (S.D.N.Y. 1985); *see also Petrella v. NL Industries, Inc.*, 529 F. Supp. 1357, 1362 (D.N.J. 1982) (employer conduct in administering severance pay plan may entitle employees to benefits).
20. 29 U.S.C. § 1144(a).
21. *Id.* (emphasis added). Included among the exceptions to ERISA's pre-emption is "any generally applicable criminal law." *Id.* § 1144(b)(4). In *Trustees of Sheet Metal Workers Int'l Ass'n Prod. Workers' Welfare Fund v. Aberdeen Blower & Sheet Metal Workers, Inc.*, 4 EBC 1219 (E.D.N.Y. 1983), the court held that, notwithstanding the criminal penalties set forth in Section 198-c of the New York Labor Law, the State statute was pre-empted by ERISA since "Congress manifested a purpose to supersede criminal laws directed specifically at employee benefit plans." *Id.* at 1200.
22. 463 U.S. 85 (1983).
23. *Id.* at 96-97.

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24. *Id.* at 98.
25. 105 S. Ct. 2380 (1985).
26. *Id.* at 2389; *see Muenchow v. The Parker Pen Co.*, 615 F. Supp. 1405 (W.D. Wis. 1985) (state law claims for misrepresentation preempted by ERISA).
27. *Holland v. Burlington Industries, Inc.* 772 F.2d 1140 (4th Cir,. 1985); *Gilbert v. Burlington Industries, Inc.*, 765 F.2d 320 (2d Cir. 1985).
28. 772 F.2d at 1144 (footnote omitted); 765 F.2d at 323.
29. In *Holland*, in addition to their ERISA claims, the 200 plaintiffs alleged causes of action based on several state statutes, including the North Carolina Wage and Hour Act, N.C. Gen. Stat. § 95-25.7, and common law claims of breach of contract and estoppel. In *Gilbert*, the state law claims of the 36 plaintiffs included "causes of actions under New York Labor Law § 198-c, North Carolina General Statutes § 95-25, and common law theories of fraud, unjust enrichment, promissory estoppel, quantum meruit, and breach of contract." 765 F.2d at 322.
30. 772 F.2d at 1143; 765 F.2d at 324. For a discussion of state law claims for severance pay in sale of assets cases, *see* DeGiuseppe, "The Effect of the Employment-at-Will Rule on Employee Rights to Job Security and Fringe Benefits," 10 Fordham Urb. L.J. 1 (1981-82).
31. In *Gilbert*, the Second Circuit remanded the action in order for the district court to determine whether defendant's denial of severance benefits to plaintiffs was arbitrary and capricious. 765 F.2d at 329.
32. *Id.* at 325.
33. 29 C.F.R. 2510.3-1(a)(3).
34. S. Rep. No. 127, 93 Cong., 2d Sess. 3 (1973) *(reprinted in* 1974 U.S. Code Cong. & Ad. News 4838, 4851).
35. 29. U.S.C. § 186(c).
36. 772 F.2d at 1145-46.
37. 463 U.S. 85 (1983).
38. 765 F.2d at 327 (citation omitted).
39. *Id.* (quoting *Shaw v. Delta Air Lines*, 463 U.S. 85,100 n.21 (1983)).
40. *Id.*
41. N.C. Gen. Stat. § 95-25.7.
42. 772 F.2d at 1149.
43. *Id.* at 1148 (quoting *Berry v. Ciba-Geigy Corp.*, 761 F.2d 1003, 1006 (4th Cir. 1985)).
44. 748 F.2d 1348 (9th Cir.), *cert. denied*, 106 S. Ct. 183 (1985).
45. 772 F.2d at 1150.
46. *See* notes 10-11 *supra*.
47. 765 F.2d at 328-29.
48. *Id.* at 329.
49. *Id.*
50. 688 F.2d 1367 (11th Cir. 1982) (en banc).
51. No. 86-C-387 (N.D. Ill. June 2, 1986).
52. 616 F. Supp. 240 (S.D.N.Y. 1985).
53. *Id.* at 243-44.
54. 641 F. Supp. 467 (S.D.N.Y. 1986).
55. *Id.* at 470-71 (citations omitted).
56. 748 F.2d 1348 (9th Cir.), *cert. denied*, 106 S. Ct. 183 (1985). *Blau* was narrowly construed by the Ninth Circuit in *Jung v. FMC Corp.*, 755 F.2d 708 (9th Cir. 1985).
57. *See Bruch v. Firestone Tire & Rubber Co.*, 640 F. Supp. 519 (E.D. Pa. 1986); *Coleman v. General Electric Co.*, No. CIV-1-84-534 (E.D. Tenn. June 23, 1986).
58. *Aquin v. Bendix Corp.*, 637 F. Supp. 657 (E.D. Mich. 1986).
59. *See, e.g., Bruch v. Firestone Tire & Rubber Co.*, 640 F. Supp. 519 (E.D. Pa. 1986); *Aquin v. Bendix Corp.*, 637 F. Supp. 657 (E.D. Mich. 1986).
60. 748 F.2d at 1352.
61. *Id.* at 1354-55.
62. 641 F. Supp. 467 (S.D.N.Y. 1986).
63. *Id.* at 471-72.
64. *See, e.g., Bruch v. Firestone Tire & Rubber Co.*, 640 F. Supp. 519 (E.D. Pa. 1986); *Lumpkin v. International Harvester Co.*, No. 81-C-6674 (N.D. Ill. Feb. 7, 1986); *Ausloos v. Chromalloy American Corp.*, 626 F. Supp. 324 (E.D. Wis. 1986); *accord Sly v. P.R. Mallory & Co.*, 712 F.2d 1209 (7th Cir. 1983).
65. The Court recently agreed to review whether the severance pay provisions of Maine's plant closing statute are pre-empted by ERISA or the LMRA. *See Fort Halifax Packing Co. v. Ewing*, 55 U.S.L.W. 3331 (U.S. Nov. 11, 1986) (No. 86-341).

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