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ERISA Litigation

Can You Have Too Much of a Good Thing? Plan Administrator Discretion in Identifying Severance Plan Participants

By Alexis E. Bates and Joseph J. Torres

In enacting the Employee Retirement Income Security Act of 1974 (“ERISA”), Congress gave employers broad discretion to voluntarily offer employees welfare benefits, or not. Consistent with that statutory flexibility, employers also enjoy a greater ability to set the requirements for welfare benefits than they do for pension benefits.¹ The rationale behind this policy choice was to encourage employers to offer welfare benefits, because they would have the ability to amend or terminate them as circumstances or business conditions warranted.²

However, Congress also enacted requirements that were intended to drive certainty and provide some level of disclosure and information to plan participants. First and foremost, where employers choose to sponsor any type of welfare benefit or pension plan, the plan terms must be set forth in a written document.³ In addition, the plan document must provide clear and consistent rules for processing benefit claims, and plans must also give notice and the opportunity for a full and fair review of participants’ claims that they were denied the benefits provided for in the plan.⁴ As is relevant to the issues addressed in this column, these principles apply with equal force to severance plans.⁵

Consistent with the legislative theme of welfare benefit plan flexibility, plan sponsors may also grant themselves discretion in the plan documents to make benefits determinations or to construe the terms written in those documents.⁶ And if plan sponsors elect to grant themselves that

Alexis E. Bates is an associate in Jenner & Block LLP’s Chicago office and a member of the firm’s ERISA litigation practice. Joseph J. Torres, a partner in the firm’s Chicago office, is chair of the firm’s ERISA litigation practice. They can be reached at abates@jenner.com and jtorres@jenner.com, respectively.

flexibility, courts generally review a plan sponsor's exercise of that discretion with deference, and uphold it unless it is "downright unreasonable."⁷

But all this flexibility raises a question that has been repeatedly posed over time in a variety of contexts: Can you have too much of a good thing?⁸ As it turns out, a plan sponsor can give itself too much discretion and thereby transform the plan into more of an ad hoc arrangement than an ERISA welfare benefit plan.⁹ This column looks at some recent case developments that examine how this balance can be struck in the context of severance plans.

Specifically, two recent cases address eligibility requirements for severance benefits that give plan sponsors and administrators the maximum amount of discretion and flexibility to select or exclude plan participants, even at the moment those employees would become eligible to participate. Both plans at issue in these cases required that, to be eligible to participate in the plan, employees must receive notice from the plan sponsor or administrator informing them that they were in fact eligible. Because the plain language of both plans clearly laid out these eligibility requirements, as well as the plan sponsor's or administrator's discretion to interpret them, courts upheld the requirements under ERISA.

SOTO V. DISNEY SEVERANCE PAY PLAN

In *Soto v. Disney Severance Pay Plan*,¹⁰ a 2020 decision, the U.S. District Court for the Southern District of New York analyzed Disney's requirements for eligibility to participate in its severance plan. One of Disney's requirements was that an employee must have been "specifically informed in writing that [she is] a Participant."¹¹ The court referred to this as Disney's notice requirement, and concluded that the case began and ended with it.¹² Because the plaintiff alleged in her complaint that she never received the requisite notice informing her that she was a participant, she was not eligible to participate. Based on the pleadings alone, the court dismissed the plaintiff's claim that she was wrongfully denied benefits (among other claims), denied her leave to replead, and entered judgment for Disney.

The plaintiff challenged the notice requirement, and more specifically, the "unilateral discretion" that the plan afforded the plan administrator to issue the notice or not. The plan described that discretion as "complete authority, in [the administrator's] sole and absolute discretion, to construe the terms of the Plan . . . and to determine the eligibility for, and amount of, benefits due under the Plan to Participants."¹³ The plaintiff argued that the plan administrator's discretionary authority impermissibly transformed the ERISA-qualified severance plan into an "ad hoc severance plan" and removed "the Plan from the realm of ERISA."¹⁴

The court explained that to be an ERISA-qualified plan, Disney's severance plan must require more uniformity and ongoing administration than simply "writing a check."¹⁵ The court concluded that, notwithstanding the

discretion, “there [was] an ERISA qualifying plan between the parties, there [was] a plan administrator, and there [were] standards by which decisions [were] made.”¹⁶ Further, the court noted “that the Plan create[d] a detailed formula to determine benefits, a procedure to submit claims, and a two-step procedure for administrative decision-making on benefit claims.”¹⁷

The plaintiff further argued that Disney’s plan allowed the plan administrator to deny benefits “on a whim” because the plan documents that gave the administrator discretion omitted the criteria by which the administrator was allowed to exercise that discretion.¹⁸ The court rejected the argument, affirming that “clear language in an ERISA plan conferring discretion upon an employer to determine eligibility must be enforced,” and that there was no requirement to further elaborate on that discretion in the plan documents.¹⁹

The U.S. Court of Appeals for the Second Circuit affirmed the decision, but based on different reasoning.²⁰ Instead of analyzing the plan administrator’s exercise of its discretion in declining to notify the plaintiff that she was a participant, the Second Circuit affirmed as reasonable the plan administrator’s underlying reason for declining to do so: the employee failed to satisfy another of the plan’s eligibility requirements; namely, her termination was not a layoff.²¹ Applying the arbitrary and capricious standard of review, the Second Circuit analyzed the plan’s definition of a layoff, and determined that the plan administrator had reasonably interpreted it, according to its authority.²²

Judge Sullivan dissented. He disagreed with the majority’s interpretation of the word “layoff,” and concluded that it applied in the plaintiff’s circumstances, making the plan administrator’s decision to the contrary arbitrary and capricious, and thereby making the denial of benefits also arbitrary and capricious.²³

Neither the majority, nor the dissent addressed the district court’s analysis of the plan’s grant of unilateral discretion to its administrator. Thus, nothing in the Second Circuit analysis takes issue with the district court’s analysis. Moreover, both parts of the opinion similarly ignored Disney’s notice of eligibility requirement for plan participation. Therefore, once again, nothing in the Second Circuit’s opinion rejects the lower court’s reasoning.

CARLSON V. NORTHROP GRUMMAN SEVERANCE PLAN

More recently, the U.S. District Court for the Northern District of Illinois analyzed similar eligibility requirements in Northrop Grumman’s severance plan and allegations that the denial of benefits under those requirements was arbitrary and capricious.²⁴ In the end, the court entered judgment for Northrop Grumman on all three claims alleged: to recover benefits under ERISA Section 502(a)(1)(B), for unlawful interference under Section 510, and for equitable reformation under Section 502(a)(3).

Like the Disney plan discussed above, to be eligible for severance benefits, Northrop Grumman required that employees must have received a memo, addressed to them individually, and signed by the company's vice president of human resources, informing them of their eligibility to participate in the severance plan.²⁵

Implicitly, it was up to the plan sponsor to make the business decision through the vice president whether to issue each memo and designate recipients as eligible, or to withhold the memo and exclude them from the plan.²⁶ The plan sponsor was free to make that decision at the time of each employee's termination, based on any number of undisclosed factors it found relevant at that point, including financial considerations. The plan sponsor thus had complete discretion to select or limit the plan's participants.

Analyzing the plain text of the summary plan description that addressed Northrop Grumman's severance benefits, the court upheld the committee's decision. The court reasoned that the obvious reading of the plan language was that the HR memo was required for eligibility. Plaintiffs' arguments to the contrary all failed, including that issuance of the HR memo was merely an administrative step, that basic contract principles should apply, and that the committee impermissibly differentiated between cash severance and non-cash severance.²⁷ The court came back again and again to the unambiguous plan language requiring the HR memo for eligibility to participate in the plan.

The most interesting of plaintiffs' arguments was that the severance plan's eligibility requirements led to an absurd result. They pointed out that the policy allowed the plan sponsor to withhold the HR memo and then rely on that withholding to deny benefits.²⁸ Plaintiffs cited for support *Swaback v. American Information Technologies Corporation*.²⁹ In *Swaback*, the U.S. Court of Appeals for the Seventh Circuit held under a theory of "basic contract law that a party who prevents the occurrence of a condition precedent may not stand on that condition's non-occurrence to refuse to perform his part of the contract."³⁰ But the defendant in that case prevented the occurrence of the condition precedent through repeated misrepresentations.³¹ By contrast, the district court concluded that there was no evidence of any such misrepresentations by Northrop Grumman, dooming both the plaintiffs' denial of benefits claim and the fiduciary breach claim.³² The court also noted that ERISA benefits often rely on things within the plan sponsor's complete control, including the decision of whether to offer the benefits at all.³³

The court also explained that building into the plan nearly complete employer discretion to define eligibility is permissible under ERISA, stating that "when a benefits plan expressly affords an employer such discretion over eligibility, it is not prohibited discrimination [under ERISA Section 510] for the employer to exercise that discretion."³⁴

TAKEAWAYS

Both cases provide useful guidance regarding how a plan sponsor can significantly control whether and when to grant severance benefits, while staying within ERISA's mandates for compliant benefit plans. Two key takeaways, as reflected by these cases, are: (a) put it in writing, and (b) clearly communicate those requirements to plan participants.

One other key takeaway is that a plan must be drafted to expressly provide plan sponsors or plan administrators full discretion to interpret those eligibility requirements. That way, if, despite the drafter's best intentions, the plan's language is found to be ambiguous and plan fiduciaries follow that language, then the results of that process will not offend ERISA.

Following these points should offer plan sponsors the maximum amount of flexibility and control over who meets their plan eligibility requirements and is thus able to participate in the plan. However, these decisions also provide an important point of caution for plan sponsors. That is, discretion may be viewed as so unfettered that the plan ceases to be viewed as a compliant ERISA plan. So, a plan sponsor must be careful to reasonably balance its desire for discretion with having plans that provide some level of certainty and information for plan participants.

Notes

1. *Black & Decker Disability Plan v. Nord*, 538 U.S. 822, 823 (2003) (“[E]mployers have large leeway to design . . . welfare plans as they see fit.”); *see also Shaw v. Delta Air Lines, Inc.*, 463 U.S. 85, 90-91 (1983); *Sejman v. Warner-Lambert Co.*, 889 F.2d 1346, 1348-49 (4th Cir. 1989).

2. *Curtiss-Wright Corp. v. Schoonejongen*, 514 U.S. 73, 78 (1995).

3. 29 U.S.C. § 1102(a)(1). *See also Curtiss-Wright Corp.*, 514 U.S. at 83; *Heimeshoff v. Hartford Life & Acc. Ins. Co.*, 571 U.S. 99, 108 (2013); *Varity Corp. v. Howe*, 516 U.S. 489, 497 (1996).

4. 29 U.S.C. § 1133.

5. *E.g., Sejman*, 889 F.2d at 1347.

6. *Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101, 111 (1989).

7. *Carr v. Gates Health Care Plan*, 195 F.3d 292, 294 (7th Cir. 1999); *see also White v. Sundstrand Corp.*, 256 F.3d 580, 584 (7th Cir. 2001).

8. William Shakespeare, *As You Like It*, act 4, sc. 1.

9. *Schnitzer v. Bank Leumi USA*, No. 09-cv-3171, 2010 WL 3069646, at *4 (S.D.N.Y. July 29, 2010).

10. *Soto v. Disney Severance Pay Plan*, No. 19-cv-4048, 2020 WL 6564721 (S.D.N.Y. Nov. 9, 2020), *aff'd*, 26 F.4th 114 (2d Cir. 2022).
11. 2020 WL 6564721, at *1.
12. *Id.* at *3.
13. *Id.* at *2.
14. *Id.* at *4.
15. *Id.* (quoting *Fort Halifax Packing Co. v. Coyne*, 482 U.S. 1, 11 (1987) (alterations omitted)).
16. *Id.*
17. *Id.*
18. *Id.* at *5.
19. *Id.*
20. *Soto v. Disney Severance Pay Plan*, 26 F.4th 114, 117 (2d Cir. 2022).
21. 26 F.4th at 120.
22. *Id.*
23. *Id.* at 25.
24. No. 13-cv-02635, 2022 WL 971873 (N.D. Ill. Mar. 31, 2022). Appeal to the U.S. Court of Appeals for the Seventh Circuit was filed on May 2, 2022.
25. 2022 WL 971873, at *4.
26. *Id.* at *2.
27. *Id.* at *4-5.
28. *Id.* at *6.
29. 103 F.3d 535, 542-43 (7th Cir. 1996).
30. 103 F.3d at 542.
31. *Id.*
32. 2022 WL 971873, at *6, *8.
33. *Id.* at *6.
34. *Id.* at *7.

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