WRMarketplace

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TOPIC: A Cautionary Tale on Informal Benefit Arrangements – Standalone Life Insurance Policies

MARKET TREND: A district court in the Seventh Circuit holds that employer-owned life insurance policies covering four key employees constitute a part of a plan subject to Employee Retirement Income Security Act of 1974 ("ERISA"), even without a written plan document.

SYNOPSIS: In *Alberth v. Southern Lakes Plumbing & Heating, Inc.*, an employer purchased and paid the premiums on life insurance policies covering four of its key employees. When one of the key employees left the employer, he requested the cash value of his policy. There was, however, no formal plan document or agreement addressing access to the policy cash value. Further, a key employee had been paid the policy cash value when he previously left the employer. The employer claimed the former employee was not entitled to the cash value of the policy. The former employee then made multiple requests for copies of the policy documents. After the employer refused his requests, the former employee sued. The former employee claimed the surrounding circumstances demonstrated that the life insurance policies covering the four key employees constituted an ERISA plan, and sued the employer for failure to provide information about the plan and for benefits under the plan. The employer argued that no ERISA plan was created because it had entered into separate *ad hoc* agreements with the former employee and the other key employees.

The Court found that the death benefits provided through the policies to the key employees constituted an ERISA plan, based on the existence of an administrative scheme and reasonably ascertainable terms,

even in the absence of a written plan document. As a result, the Court ruled that the employer's refusal to provide policy documents triggered certain ERISA penalties and that the case should proceed to trial on whether the former employee indeed had a right to the policy cash value.

TAKEAWAYS: The facts and holding in *Alberth* highlight at least three important lessons for employers that maintain informal or unwritten employee benefit arrangements:

(1) One-off life insurance arrangements with employees should be carefully reviewed to determine if ERISA applies. If an arrangement is subject to ERISA and has not been maintained in compliance with ERISA, an employer could face ERISA litigation and DOL and IRS penalties.

(2) Put unwritten arrangements into writing. Having a formal written understanding of the arrangement can help employers and participants better understand their rights with respect to the arrangement.

(3) Administrative precedent is important. Employers should document all of their administrative decisions, so in the event of litigation they have a record to support their decision.

Prologue

In *Alberth v. Southern Lakes Plumbing & Heating, Inc.*,[1] a district court in the Seventh Circuit found that individual life insurance policies were part of an employee welfare benefit plan subject to ERISA, despite the lack of a written plan document.

In this article, we look at the story behind this decision and explore lessons learned.

Act 1: The Company-Provided Life Insurance Benefit

In 2004, Scott Plucinski, the owner of Southern Lakes Plumbing & Heating, Inc. ("Southern Lakes") purchased life insurance policies for four key employees, including the plaintiff, Raymond Alberth. Plucinski was the named owner on the policies but allowed each employee to designate a beneficiary. Southern Lakes paid all of the premiums on the policies.

Plucinski referred to these policies as "key man" polices, but they differed from normal key man policies in that policy death benefits would go to the employee's named beneficiary, not Southern Lakes, in the event of the employee's death. The policies were essentially company-owned (endorsement) split-dollar life insurance arrangements. Plucinski, however, had no written agreements with the employees about their rights under the policies.

The policies built up cash value over time. The four employees apparently believed that if they worked for a number of years – several employees thought that Plucinski told them at least five years – they would get to keep the cash value in the policy when they left the company. Plucinski denied ever making that representation.

In 2010, one of the other employees with the benefit, Steven Morgan, asked to receive the cash value in his policy in connection with his resignation. The policy had accrued about $7,000 in cash value at that time. Plucinski first suggested that Morgan arrange for a policy loan, but eventually, after some discussions about the mechanics, Plucinski withdrew the cash value from the policy and cut Morgan a check (after deducting amounts that Morgan owed the company).

Act 2: Alberth Wants The Cash Value from His Policy

In September 2018, Alberth resigned from Southern Lakes. In October, he first asked about receiving the cash value from his policy. He had apparently never before asked about the cash value in his policy. The published decision does not say how much cash value was in the policy, although it had a death benefit of over $500,000 and by that time had been in force for over 14 years.

In a series of growlingly adversarial exchanges, Alberth, through his attorney, demanded that Plucinski and Southern Lakes pay him the cash value in the policy and provide him with "copies of the policy, plan document, summary plan document, and all communications regarding the policy."

Plucinski and Southern Lakes denied all of these requests and provided Alberth only with a copy of the policy data page for the life insurance policy showing that Southern Lakes, not Alberth, was the owner. Plucinski denied Alberth his requested benefits because: (i) Alberth was an at-will employee; (ii) Southern Lakes was the owner of the policy; (iii) Alberth did not own the policy and has not paid any premium on the policy; (iv) Alberth was no longer a Southern Lakes employee; and (v) Alberth had no contractual arrangement with Southern Lakes that either entitled him to the life insurance benefits, a transfer of ownership of the policy, or any interest in the cash value of the policy.

Act 3: Alberth Sues for the Cash Value in His Policy and ERISA Damages

In January 2019, Alberth filed a lawsuit against Plucinski and Southern Lakes. On a motion for summary judgment, Alberth argued that given the surrounding circumstances of the arrangement, the life insurance policy was an ERISA plan. Based on this, Alberth made two demands:

- That he be paid the cash value in the policy based on his understanding of the terms of the underlying ERISA plan, under which employees with at least five years of service had a vested right to receive the policy cash value, and
- That a penalty in the amount of over $15,000 be assessed against Southern Lakes for failure to provide a copy of the ERISA plan document, summary plan description, and other documents under which the ERISA plan was governed, as required by ERISA 104(b). Under ERISA §104(b), a plan sponsor must provide copies of plan documents, summary plan descriptions, and other plan-related materials to participants within 30 days after a written request from the participant. Failure to comply can result in a penalty of up to $110 per day of failure to respond, subject to court discretion.

Plucinski and Southern Lakes, on the other hand, argued that no ERISA plan was created because Plucinski entered into separate *ad hoc* agreements with Alberth and the other key employees which did not rise to the level of a "plan" within the scope of ERISA. Plucinski and Southern Lakes also argued that even if there was an ERISA plan, no penalties should be assessed under ERISA §104(b) because Plucinski

in good faith believed there was no ERISA plan and that there was no harm since the policy was kept in force after Alberth left Southern Lakes.

Act 4: What the Court Decided

The Court was considering a motion for summary judgment by Alberth as to his claims for the policy cash value and the ERISA §104(b) penalty. In a motion for summary judgment, the Court considers the undisputed facts as presented in the light most favorable to the person who is defending against the motion, and determines whether the law applied to those facts requires a specific outcome, or whether the case should proceed to trial.

For the reasons discussed below, the Court found that the life insurance benefits provided by Southern Lakes to the four key employees did amount to an ERISA plan.

In order to determine whether ERISA applied to the life insurance policies, the Court first asked whether the policies were a part of an "employee welfare benefit plan" under ERISA. Under ERISA, an arrangement qualifies as an employee welfare benefit plan if it is:

- a plan, fund, or program,
- established or maintained,
- by an employer or by an employee organization …,
- for the purpose of providing medical, surgical, hospital care, sickness, accident, disability, death, unemployment, or vacation benefits …,
- to participants or their beneficiaries.[2]

The Court concluded that the last four elements were easily satisfied because (i) by Plucinski purchasing the policies and paying their premiums for more than decade, a scheme was "established or maintained", (ii) Southern Lakes (the employer) purchased the life insurance policies, (iii) the policies provided death benefits (one of the listed ERISA "welfare plan" benefits), and (iv) such benefits are payable to each employee's named beneficiary.

The first element – whether "a plan, fund or program" was created – was the primary issue in dispute since the policies were not part of a written plan document. The test in such cases comes from *Fort Halifax Packing Co. v. Coyne.*[3] In that case the Supreme Court held that an arrangement constituted an ERISA plan if it has both a "continuing administrative scheme" and "reasonably ascertainable terms."[4]

In *Alberth*, the Court concluded that Plucinski and Southern Lakes had established an ongoing administrative scheme by paying the premiums on the policy insuring Alberth for 14 years. Plucinski, however, argued that the terms were not reasonably ascertainable because there was no plan document and the benefits provided were purely discretionary, *ad hoc* decisions on his part. The Court, however, noted that an unwritten arrangement could still have "reasonably ascertainable terms."

To decide whether the terms of the arrangement were reasonably ascertainable, the Court examined whether a reasonable person could ascertain from the surrounding circumstances the (i) intended benefits, (ii) beneficiaries, (iii) source of financing, and (iv) procedures for receiving benefits.[5]

- Intended Benefits. Plucinski and Southern Lakes argued that because there was no written commitment to provide Alberth with access to the policy cash value after five years of employment, a reasonable person could not ascertain the intended benefits from the policy. The Court disagreed. It noted that there clearly was an intended death benefit of over $500,000 that Alberth's selected beneficiary would have received had he died. The fact that the parties disputed whether the intended benefits included access to the policy cash value did not change the fact that there was clearly at least some intended benefit.

- Intended Beneficiaries. Plucinski argued that he had other "key employees" to whom he did not provide the life insurance benefits, and since he had not established a systematic scheme or procedure for determining which employees received the benefit it was not clear who was the intended beneficiary of the arrangement. The Court rebuked the assertion, stating the real question "…is not whether the employer had consistent criteria for determining eligibility; it is whether we can ascertain who was eligible." The Court found that the policy insuring Alberth and naming his designee as the beneficiary clearly showed that he was a participant.

- Source of Financing. There was no dispute over this factor, since Plucinski purchased the policy and Southern Lakes paid the premiums on the policy.

- Procedures for Receiving Benefits. Under the terms of the arrangement, the procedures for enrolling in the program were straightforward – Plucinski offered the life insurance policy and Alberth agreed and designated a beneficiary. In order to make a claim for benefits the beneficiary would notify the insurer of the participant's death and the insurance company would pay the death benefit to the beneficiary. Further, regarding to the cash value payout option, as evidenced by Plucinski paying Morgan his cash value in 2010, an employee could request the cash value of the policy from Plucinski. While the procedure was not totally clear, there clearly was precedent for a procedure.

The Court held that each element had been satisfied and that the life insurance policy insuring Alberth was part of an "employee welfare benefit plan" subject to ERISA. This conclusion then led to two further holdings on Alberth's specific demands.

As to the claim for the cash value benefit, the Court determined that facts were in dispute and more evidence was needed. Therefore, this claim was allowed to proceed to trial.

As to the claim for over $15,000 in ERISA §104(b) penalties, the Court ruled against Plucinski and Southern Lakes and found that penalties were appropriate. Plucinski and Southern Lakes claimed that Alberth's request took them by surprise because he had already terminated employment when he made the claim; that there was no bad faith because they did not believe Alberth had a right to inspect the requested documents, as Alberth did not own the policy and they believed there was no ERISA plan in place; and Alberth was not prejudiced by the delay because he was provided with a policy data information sheet showing Southern Lakes as the owner, and that policy remained in place. The Court, however, found that neither surprise nor Plucinski's belief that no ERISA plan existed sufficiently justified denying Alberth's request for documents. The Court reasoned that "[t]he idea that Alberth could not possibly have any rights regarding the policy just because he had been an at-will employee, because he was no longer employed at Southern Lakes, or because any agreement had not been written

down, is legally erroneous." The Court also found the delay in producing the documents prejudiced Alberth because he needed the information to determine his rights under the policy and whether to pursue litigation. Lastly, the Court found that there had been bad faith by Plucinski because in responding to Alberth's request, Plucinski threatened to tell Alberth's new employer that Alberth had removed confidential information from Southern Lakes. As such, the Court found Plucinski liable for the ERISA §104(b) penalties, but deferred a decision on the amount until after the trial.

Epilogue: The Morals of the Story

The *Alberth* decision reminds us that informal arrangements, including one-off agreements providing ERISA-listed welfare benefits, can be an ERISA plan, and that being an ERISA plan has important consequences, including potential exposure to ERISA §104(b) penalties if documents are not provided when requested.

Even if the arrangement in *Alberth* had not been an ERISA plan, the fact that the arrangement was unwritten helped lead to the dispute. Had Southern Lakes provided a written understanding about the policies, such as a statement that benefits were not vested, purely discretionary, and could be changed or terminated at any time by the company, it may have been in a much stronger position with the Court.

Alberth also demonstrates that administrative precedent is important. The fact that Morgan had been paid the cash value in his policy in 2010 showed that such a benefit was potentially intended, helping Alberth's claims that there were reasonably ascertainable benefits. Employers should keep written records about their administrative decisions, and if exceptions are made, the reasons for those exceptions should be clearly documented.

Employers with informal or unwritten arrangements may want to review those arrangements and consider whether they have an ERISA plan or whether any ambiguous terms should be clarified.

Notes

[1] *Alberth v. Southern Lakes Plumbing & Heating, Inc*., (2020, E.D. WI) 2020 WL 1082775

[2] *Alberth v. Southern Lakes Plumbing & Heating, Inc*., (2020, E.D. WI) 2020 WL 1082775 (internal citations omitted); *see also* ERISA § 3(1).

[3] *Fort Halifax Packing Co. v. Coyne*, 482 U.S. 1 (1987)

[4] *Id*.

[5] *Donovan v. Dillingham*, 688 F.2d 1367 (11th Cir. 1982).