Case No. 01-8097

UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

ROBERT STERN,

Plaintiff/Appellant,

v.

INTERNATIONAL BUSINESS MACHINES CORPORATION,

Defendant/Appellee.

Appeal From the United States District
Court for the Southern District of Florida

BRIEF OF THE SECRETARY OF LABOR AS AMICUS CURIAE IN SUPPORT OF APPELLANT FOR REVERSAL

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Case No. 02-14740-HH

Robert Stern v. International Business Machines Corporation

CERTIFICATE OF INTERESTED PARTIES

Pursuant to 11th Circuit Rule 26.1-1, the undersigned counsel for the Secretary of Labor as amicus curiae supporting appellants adopts the persons and entities identified by Robert Stern, appellant, in his Certificate of Interested Persons, see appellant's brief, p. C-1, and certifies that the following additional persons also have an interest in the outcome of this case:

Elaine L. Chao, Secretary of Labor, U.S. Department of Labor

Ann Combs, Assistant Secretary for Pension and Welfare Benefits Administration, U.S. Department of Labor

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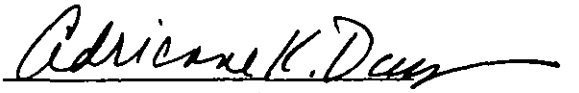

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Federal Cases: Page

Federal statutes--continued: Page

Other Authorities:

Department of Labor Advisory Opinions:

STATEMENT OF THE ISSUES

1. Whether IBM's Sickness and Accident Income Plan, which pays out of IBM's general assets the salary of an employee while he cannot work due to sickness or accidental injury, is a "payroll practice" under 29 C.F.R. § 2510.3-1(b), and therefore exempt from the definition of a "welfare benefit plan" under the Employee Retirement Income Security Act (ERISA), 29 U.S.C. § 1002.

2. If the Sickness and Accident Income Plan ("S & A Program" or "the Program") is an exempt payroll practice rather than an ERISA-covered plan, whether the district court erred in granting removal to federal court of the Plaintiff's state law claims for payments under the Program.

INTEREST OF THE SECRETARY OF LABOR

As the federal agency with primary interpretation and enforcement authority for Title I of ERISA, 29 U.S.C. § 1001, et seq., the Department of Labor has a significant interest in ensuring that courts correctly construe the statute's span of coverage. This case presents an important question regarding the scope of the Secretary's regulation at 29 C.F.R. § 2510.3-1(b) ("payroll practices regulation"), which expressly exempts from the definition of an ERISA plan a "payroll practice" under which an employer pays an employee's normal compensation during periods of disability. No court of appeals has yet published a decision interpreting Section 2510.3-1(b) in the context of the specific type of program at issue here. Therefore,

the Court's decision in this case likely will significantly affect the development of the law interpreting the Secretary's "payroll practices" regulation.

STATEMENT OF THE CASE

In July 1999, IBM employee Robert Stern fell and shattered a glass cabinet door with his dominant right hand. The fall caused tendon and nerve injuries, requiring surgery. Stern states that under duress from IBM and against his doctor's orders, he returned to work shortly after the surgery. In May 2000, Stern had a second operation on his hand. Stern's doctor imposed restrictions on his activities that Stern claims precluded him from performing his job. It appears from the complaint that Stern did not return to work after his second surgery. Complaint at pp. 6-7.[1]

IBM has a "Sickness and Accident Income Plan" ("S & A Program" or "the Program"), which provides up to 52 weeks of an employee's "regular salary" when he is unable to work due to sickness or an accident. See Exhibit A to Complaint at p. 6. The Program defines "unable to work" as "unable to perform the duties of

[1] All references in this brief to "the complaint" means the complaint filed in Florida state court on December 14, 2000.

the job you held at the time of your sickness or accident, or the duties of any other job that IBM determines that you are capable of performing." Id. at 7.[2]

IBM does not contest that it makes payments to employees who qualify for the program out of the company's general assets.

At least by September 2000, IBM found that Stern was not "unable to work" under the Program and did not pay his salary while he was absent from work following his hand injury. Instead, IBM notified Stern that he should return to work. After he apparently failed to do so, IBM fired him. Complaint at p.7.

Stern sued IBM in Florida state court. He claims that the S & A Program is part of his employment agreement with IBM. The company breached that agreement, Stern asserts, by failing to pay his salary during the period in which his

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[2] The S & A Program is described in an on-line book which sets forth a number of other requirements. See Exhibit A to Complaint. It demands that the illness or accident cause the employee to be absent more than three days. Employees must submit a "certificate of disability" from their doctor, and they must report weekly to IBM and indicate if they will be away from home for more than five days during their period of disability. IBM determines whether a particular employee qualifies for the Program and may require the employee to be examined by a physician of IBM's choice. The Program does not cover absences for an employee's treatable illness if that employee "refuse(s) to follow the corrective regimen which IBM determines you are reasonably able to follow." IBM reserves the right under the Program to terminate the employment of Program recipients for certain business reasons, including reductions in force, and stops paying the salary of recipients if their employment is so terminated. Exhibit A to Complaint at pp. 7-8.

hand injury caused him to be unable to work, and also by terminating him. Complaint at pp. 7-8. Stern additionally seeks a declaratory judgment that he remains "unable to work" and that the S & A Program entitles him to his salary while he is unable to work. Id. at pp. 9-10.

IBM removed the case to the United States District Court for the Southern District of Florida, claiming that the S & A Program amounts to an ERISA "welfare benefit plan." IBM argued that because the Program constitutes an ERISA plan, the statute preempts Stern's state law action to declare his rights under the Program and for benefits under the Program. Notice of Removal at pp. 1-2. Therefore, IBM moved to dismiss the complaint for failure to state a claim under ERISA.

Stern moved to remand the case to state court, asserting that the federal court lacked subject matter jurisdiction. He argued that the Secretary's regulation at 29 C.F.R. Section 2510.3-1(b)(2) specifically provides that programs such as the S & A Program are "payroll practices" which are exempt from the definition of an ERISA-covered welfare benefit plan. Stern's Motion for Remand at pp. 5-10.

The District Court denied Stern's motion to remand. Without analyzing or even mentioning the Secretary's "payroll practices" regulation, the court stated that the plan meets the factors set forth by the Eleventh Circuit in Donovan v. Dillingham, 688 F.2d. 1367 (1982), as relevant to determining the existence of an

ERISA plan. See District Court's Order, p. 2 (Apr. 16, 2001). The court therefore held that the S & A Program, as described by the complaint, is an ERISA plan. Id. Accordingly, the court granted IBM's motion to dismiss the state complaint and gave Stern leave to file an amended complaint asserting claims under ERISA. Id. at 2-3. The court later found that IBM had not violated ERISA and granted summary judgement for IBM. See District Court's Order (July 29, 2002).

ARGUMENT

I. IBM'S SICKNESS AND ACCIDENT INCOME PLAN IS A "PAYROLL PRACTICE" UNDER 29 C.F.R. SECTION 2510.3-1(B)(2), AND THEREFORE IS EXCLUDED FROM ERISA'S DEFINITION OF A "WELFARE BENEFIT PLAN"

ERISA covers two types of "employee benefit plans" -- "employee pension benefit plans," which primarily provide retirement income, and "welfare benefit plans," which provide other types of benefits such as medical care and disability insurance. 29 U.S.C. § 1002. IBM asserts that its S & A Program is an "employee welfare benefit plan," and that consequently Stern's suit was in fact a claim for benefits under ERISA even though it was cast as a breach of contract claim under state law.

As relevant here, ERISA Section 3(1) defines "employee welfare benefit plan" as:

> any plan, fund, or program ... maintained by an employer ... for the purpose of providing for its participants or their beneficiaries, through the purchase of insurance or otherwise ..., medical, surgical, or hospital care or benefits, or *benefits in the event of sickness, accident, disability,* death or unemployment, or vacation benefits . . ..

29 U.S.C. § 1002(1) (emphasis added).

The statute gives the Secretary of Labor broad rule-making authority and specifically authorizes the Secretary to define the statute's technical and trade terms. 29 U.S.C. § 1135. The Supreme Court has made clear that the Secretary's regulatory choices in this regard are entitled to deference so long as they are reasonable. Massachusetts v. Morash, 490 U.S. 107, 116 (1989). At issue in this case is the Secretary's regulation at 29 C.F.R. § 2510.3-1(b), which states that an employer's "payroll practices" are not ERISA welfare benefit plans. Under this regulation, "payroll practices" include:

> [p]ayment 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 (such as a pregnancy, a physical exam or psychiatric treatment).

Id. (emphasis added).

The S & A Program fits neatly into the regulation's definition of a "payroll practice." The Program pays the employee's "regular salary" out of IBM's general assets on account of periods of time during which "you are unable to work because you are sick or have an accident." Exhibit A to Complaint at pp. 5-6. Therefore, the S & A Program clearly is a payroll practice and not an ERISA plan.[3]

The Secretary's Advisory Opinions consistently have confirmed that programs like the S & A Program meet the definition of a payroll practice under Section 2510.3-1(b). For example, the Secretary concluded that two programs offered by Toyota Motor Manufacturing, which bear a striking resemblance to IBM's Program, were payroll practices rather than ERISA plans. Like the S & A Program, Toyota's programs paid out of general corporate assets up to 100% of the salary of employees who were rendered incapable of performing their jobs by a physical or mental condition. As does the S & A Program, Toyota's programs also required a doctor's certification, left discretion as to eligibility with the employer, subtracted from program payments workers' compensation and Social

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[3] Under the Program, "regular salary" is the employee's "regular monthly compensation for regularly scheduled hours, not over 40 hours a week." See Attachment A to Complaint at p. 5. (Exhibit A to Complaint at p. 5). IBM subtracts from the payment workers' compensation payments and Social Security payments received by an employee in order to ensure against overcompensation. Id.

Security payments received, and ended payments upon termination of employment. Id.

The Secretary found that because Toyota's programs made payments "from the general assets of the Employer for absence due to certain medical reasons and that such payments either equal, or represent a significant portion of, an employee's normal compensation, but in no event exceed an employee's normal compensation," they were "payroll practices" under Section 2510.3-1(b), and therefore were not ERISA plans. 93-27A Advisory Opinion (Oct. 12, 1993); see also 93-20A Advisory Opinion (July 16, 1993) (same); 93-02A Advisory Opinion (Jan. 12, 1993) (same); and 92-18A Advisory Opinion (Sept. 30, 1992) (same). The Secretary's Advisory Opinions leave no doubt that IBM's S & A Program constitutes a payroll practice exempt from coverage under ERISA.

The court below ignored the payroll practices regulation and all of the Secretary's advisory opinions interpreting it. Instead, the court found the S & A Program to be an ERISA plan based on its overly mechanical application of this Court's decision in Dillingham. There, this Court held that an ERISA plan exists only where a reasonable person can readily ascertain "the intended benefits, a class of beneficiaries, the source of financing, and procedures for receiving benefits." 688 F.2d at 1373. Dillingham, however, was concerned with defining the minimum

characteristics of an ERISA plan. The Court did not, in Dillingham or elsewhere, address the scope of the Secretary's payroll practices regulation. For this reason, Dillingham is largely irrelevant to the issue presented here, and the court below erred in finding that it rendered the S & A Program an ERISA plan.

The decisions of other courts that have had occasion to interpret Section 2510.3-1(b) clearly support the Secretary's view in this case. For instance, the First Circuit in McMahon v. Digital Equip. Corp., 162 F.3d 28 (1998), determined that a program which paid an employee's salary while he was disabled was an ERISA plan, but only because it was partially funded from sources outside of the employer's general assets. If the employer had made payments under the program only from its general assets, the court stated, it would have qualified as a payroll practice. Id. at 36. The court explained, "where an employer pays occasional, temporary benefits from its general assets, there is no benefits fund to abuse or mismanage and no special risk of loss or nonpayment of benefits." Id. Similarly, in Capriccioso v. Henry Ford Health Sys., No. 99-1369, 2000 WL 1033030 (6th Cir. July 17, 2000) (unpublished), the Sixth Circuit found that a program that paid

full salary to disabled employees was a payroll practice specifically because the salary was paid out of the employer's general assets. Id. at *2.[4]

IBM, like the district court below, ignores the sound reasoning of these decisions, the Secretary's Advisory Opinions as well as the plain language of Section 2510.3-1(b). Instead, IBM mistakenly relies on language in the Supreme Court's decision in Morash as bolstering its theory that the S & A Program is not a payroll practice. Morash, however, supports rather than undermines the S & A Program's status as a payroll practice.

In Morash, an employer was charged with violating a state criminal law by failing to pay accrued vacation leave to two terminated employees. The employer argued that ERISA preempted the state law because its vacation leave policy constituted a welfare benefit plan under ERISA. 490 U.S. at 109-11. The vacation policy allowed employees to accumulate their unused vacation leave and receive it as a lump-sum payment upon discharge. The employer argued that this

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[4] See also Alaska Airlines, Inc. v. Oregon Bureau of Labor, 122 F. 3d 812 (9th Cir. 1997) (finding sick leave policy paid from general assets a payroll practice under Section 2510.3-1(b) in part because employees relied on financial health of employer to receive payments under the policy); Funkhouser v. Wells Fargo Bank, N.A., 289 F.3d at 1137, 1142 (9th Cir. 2002) (finding sick and vacation policies paid from general assets payroll practices under Section 2510.3-1(b)); Shea v. Wells Fargo Armored Serv. Corp., 810 F.2d 372 (2d Cir. 1987) (same).

accumulated lump-sum payment feature was akin to a severance plan, which the regulation does not exempt and ERISA indisputably covers. Id. at 112.

The Supreme Court disagreed. It found that the employer's vacation leave policy did not amount to an ERISA-covered plan, but rather was a payroll practice under subsection (c) of Section 2510.3-1, which excludes certain vacation and holiday pay programs from ERISA coverage. Just like subsection (b) at issue here, subsection (c) exempts only those programs paid "out of the employer's general assets." Id. at 116-18. The Court found that the fact that the employer paid the vacation leave from its general assets placed the vacation program squarely inside the payroll practices regulation. Id. at 115; see also id. at 120 (emphasizing rationale applies to "payments by a single employer out of its general assets") .

In so holding, the Court rejected the argument that the vacation pay program paralleled ERISA-covered severance pay plans. The Court pointed out that, unlike severance plans which pay benefits only upon termination, the employee's right to accrued vacation leave was not "contingent upon some future occurrence" such as termination. Id. at 116; see also id. at 115 & 120.

In its attempt to classify the S & A Program as an ERISA plan, IBM takes out of context this statement in Morash that the vacation policy there was a payroll practice in part because payments under the policy did not depend on some

contingent future event. IBM then contends that its S & A Program is "contingent" on an employees' demonstration of their eligibility for S & A payments - i.e., that they cannot work because of sickness or an accident, and is therefore not a payroll practice. IBM's Opposition to Motion for Remand at pp. 5-6.

IBM's misconstrues the meaning of a benefits-triggering "contingency" referred to in Morash. The Morash Court stressed that payment of vacation leave does not depend on future contingencies in order to distinguish it from severance plans which are contingent upon termination, and which the payroll practices regulation does not expressly include. See 490 U.S. at 120.

Moreover, if courts were to adopt IBM's view that all programs which rely in any way on a "contingency" fall outside of the payroll practices exemption, then the inclusion of "sick leave" in Section 2510.3-1(b) would be meaningless, since all sick leave policies are "contingent" on the employee's inability to work for some sort of medical reason. Such a rule -- essentially holding that sickness or injury is a "contingency" that disqualifies sick pay programs from the payroll practices regulation -- would directly contravene the holding of the Court in Morash, which viewed its decision as fully in line with the regulation and expressly recognized that the regulation encompasses "paid sick leave." 490 U.S. at 117; see also Shea v. Wells Fargo Armored Servs., 810 F.2d 372, 376 (2d Cir. 1987) (holding that a sick

leave policy was a payroll practice in part because the employer paid the leave "without additional conditions or contingencies of any kind"). Cf. Alaska Airlines, Inc. v. Oregon Bureau of Labor, 122 F.3d 812, 814 (9th Cir. 1997) (holding that sick leave system was a payroll practice because the employees "depend on their employer for sick pay in the same way that they depend on it for wages. The risk of non-payment in those circumstances was viewed by Morash as lying beyond the purpose of ERISA").

Taking a different tack, IBM also relies on this Court's language in Whitt v. Sherman International Corp., 147 F.3d 1325, 1330 (11th Cir. 1998), citing Williams v. Wright, 927 F.2d 1540, 1544 (11th Cir. 1991), for the proposition that "payment of benefits out of an employer's general assets does not affect the threshold question of ERISA coverage." However, IBM wrongly relies on this language because neither Williams nor Whitt involved the question of what constitutes a payroll practice under Section 2510.3-1(b). Indeed, in determining when an ERISA plan was first adopted, Whitt focused on the point at which beneficiaries could have determined their rights, and was not concerned at all with the source of funding.

The source of funding was implicated in Williams, but in a different way. Williams involved whether an employer's promise to pay a retiree $500 a month

constituted an ERISA plan, the benefits of which the statute requires be paid out of a trust. See id. at 1544, citing 29 U.S.C. § 1103. The employer in Williams argued that the fact that it would pay the $500 out of its general assets meant that the plan had no "source of financing" as required by Dillingham, and that therefore its promise could not constitute an ERISA plan. In rejecting that argument, the Court merely ruled that an employer cannot circumvent ERISA coverage by paying from its general assets what the statute requires be paid from a separate trust. Id. The Court did not rule that the fact that an employer pays benefits from general assets is never relevant to the question of whether an ERISA plan exists.

Indeed, IBM's view that an employer's payment of benefits out of its general assets is irrelevant to the determination of the existence of an ERISA plan calls into question the entire payroll practice regulation. After all, the fact that a program is paid from general corporate assets is one of the basic requirements for meeting the payroll practices exemption. Once again, IBM cannot realistically reconcile its reading of the cases with Morash, which expressly gave deference to the Secretary and upheld the validity of the regulation, at least with regard to vacation pay. 490 U.S. at 116.

Accordingly, there is no cause to doubt the reasonableness and validity of the payroll practices regulation. This regulation makes it abundantly clear that the

payment of an employee's salary out of the employer's general assets when the employee is physically or mentally unable to perform his job is a payroll practice. 29 C.F.R. § 2510.3-1(b)(2). That is exactly what the S & A Program does. Therefore, under the terms of Section 2510.3-1(b), the S & A Program is not an ERISA-covered plan.

II. BECAUSE STERN'S CLAIM UNDER STATE CONTRACT LAW RELATES TO AN EXEMPT PAYROLL PRACTICE AND NOT TO AN ERISA PLAN, THE CASE WAS NOT PROPERLY REMOVED TO FEDERAL COURT UNDER THE "COMPLETE PREEMPTION" DOCTRINE

Under 28 U.S.C. Section 1441(b), a state court action founded on a claim arising under Federal law may be removed to federal court. Normally, "a cause of action arises under federal law only when the plaintiff's well-pleaded complaint raises issues of federal law." Metropolitan Life Ins. Co. v. Taylor, 481 U.S. 58, 63 (1987). However, a corollary to this well-pleaded complaint rule "is that Congress may so completely pre-empt a particular area that any civil complaint raising this select group of claims is necessarily federal in character." Id. at 63-64; see also Whitt, 147 F.3d at 1325; Kemp v. International Business Machs. Corp., 109 F.3d 708, 712 (11th Cir. 1997). In Metropolitan Life, the Court held that a state law claim alleging improper processing of a claim for benefits under an ERISA plan fell within

this "complete preemption" or "super preemption" doctrine. The Court reasoned that such a claim is in reality an ERISA claim because it comes within the scope of Section 502(a)(1)(B) of ERISA, 29 U.S.C. § 1132(a)(1)(B), "which provides an exclusive federal cause of action for resolution of such disputes." 481 U.S. at 63.

In such a case, the Court will recharacterize the state law claim so that it includes the necessary federal question because, under the complete preemption doctrine, a state law claim within the completely preempted area "is considered, from its inception, a federal claim, and therefore arises under federal law." Rivet v. Regional Banks of La., 522 U.S. 470, 476 (1998). Conversely, however, a state law claim that does not fall within the scope of ERISA Section 502(a) does not arise under federal law. Such claims are not removable even where a valid federal preemption defense to the claim exists. Franchise Tax Bd. of State of Calif. v. Construction Laborers Vacation Trust for S. Calif., 463 U.S. 1, 25-27 (1983); accord Whitt, 147 F.3d at 1330.

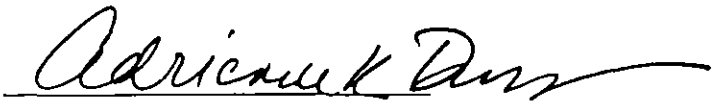
As explained in Section I above, the S & A Program is not an ERISA-covered plan. Consequently, Stern's action for payments under the Program is not "completely preempted." Because his claim does not involve an ERISA plan at all, it cannot be characterized as an ERISA claim within the scope of Section 502(a). Accordingly, no federal question exists, and the district court lacks jurisdiction

over this matter. Therefore, the district court erred in denying Stern's motion to remand the action to the Florida state court.

CONCLUSION

For the reasons stated above, the Secretary of Labor respectfully requests that this Court reverse the district's court's ruling, and order that court to remand this action to state court.

Respectfully submitted,



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Dated: October 15, 2002

CERTIFICATE OF COMPLIANCE

Pursuant to Fed. R. App. P. 32(a)(7), I certify that the attached Brief of the Secretary of Labor as Amicus Curiae in Support of Appellant's Argument for Reversal contains 3,880 words.

Dated: October 15, 2002

Delores E. Durham

Delores E. Durham

CERTIFICATE OF SERVICE

I hereby certify that on October 15, 2002, two copies of the Brief of the Secretary of Labor as Amicus Curiae in Support of Appellant for Reversal were mailed, via federal express courier service, to the following parties:

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