No. 02-458

In the Supreme Court of the United States

RAYMOND B. YATES, M.D., P.C. PROFIT SHARING PLAN, AND RAYMOND B. YATES, TRUSTEE, PETITIONERS

v.

WILLIAM T. HENDON, TRUSTEE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

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QUESTION PRESENTED

Whether the working owner of a business (here, the sole shareholder of a corporate employer) is precluded from being a "participant" under Section 3(7) of the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. 1002(7), in an ERISA plan.

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This brief is submitted in response to the Court's order inviting the Solicitor General to express the views of the United States.

STATEMENT

This case presents the question whether a working owner (such as a sole shareholder, sole proprietor, or partner who renders services to a business) may be a participant in an ERISA plan. The court of appeals' holding that working owners are precluded from being ERISA participants erroneously disregards this Court's precedent, the text of ERISA, and guidance provided by the Department of Labor. The decision deepens a conflict among the courts of appeals on an important issue and thus warrants this Court's review.

1. Dr. Raymond B. Yates was a practicing physician and the sole shareholder and president of a professional corporation known as Raymond B. Yates, M.D., P.C. Pet. App. 2a, 10a. The corporation maintained the Raymond B. Yates, M.D., P.C. Profit Sharing Plan (the plan), for which Dr. Yates was the plan administrator and trustee. *Id.* at 2a-3a. As of June 30, 1996, four persons were designated as plan participants, including Dr. Yates. *Id.* at 3a. From its inception, the plan always had at least one participant other than Dr. Yates or his wife. See *id.* at 10a.

The plan was tax-qualified under Section 401 of the Internal Revenue Code, 26 U.S.C. 401, see Pet. App. 2a-3a, and contained an anti-alienation provision as required both by the Code, 26 U.S.C. 401(a)(13), and by the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. 1056(d). Pet. App. 4a. That provision, entitled "Spendthrift Clause," provided in relevant part:

> Except for Plan loans to Participants as permitted by ARTICLE 12 and the assignments provided therefor, no benefit or interest available hereunder will be subject to assignment or alienation, either voluntarily or involuntarily.

Id. at 11a. Article 12 of the plan, which authorized participant loans, also imposed various requirements specified by ERISA and the Code, including that the loan be adequately secured by the participant's accrued benefit, that the loan bear a reasonable rate of interest, and that the participant make repayments at least quarterly over a period not to exceed five years. C.A. App. 235-236; see 29 U.S.C. 1056(d)(2), 1108(b)(1); 26 U.S.C. 72(p)(2)(B) and (C), 401(a)(13)(A), 4975(d)(1).

In December 1989, Dr. Yates borrowed $20,000 from the plan at 11% interest and pledged as security his vested account balance in the plan. Pet. App. 3a, 11a. The loan was originally for five years, but it was extended for another five years in June 1992. *Id.* at 3a. Although the loan terms required monthly payments of $433.85, Dr. Yates made no payments on the loan until November 1996, when he repaid the entire principal and interest due in two payments that totaled $50,467.46. *Id.* at 3a, 11a. On December 2, 1996, three weeks after the repayment, an involuntary bankruptcy petition was filed against Dr. Yates under Chapter 7 of Title 11 of the United States Code (11 U.S.C. 701 *et seq.*). Pet. App. 3a.

2. Several months later, respondent William T. Hendon, the trustee in bankruptcy, commenced this adversary proceeding under 11 U.S.C. 547(b) and 550 against the plan and Dr. Yates as plan trustee (petitioners herein) in the United States Bankruptcy Court for the Eastern District of Tennessee. Respondent asked the court to set aside the loan repayment as a preferential transfer and to order the plan to pay the money to respondent. Pet. App. 3a. The parties each filed motions for summary judgment. *Id.* at 37a. The court granted summary judgment to respondent. *Id.* at 36a-50a.

The court rejected petitioners' argument that Dr. Yates's interest in the plan was excluded from his bankruptcy estate under 11 U.S.C. 541(c)(2). Pet. App. 43a-47a. Section 541(c)(2) provides: "A restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title." 11 U.S.C. 541(c)(2). In *Patterson* v. *Shumate*, 504 U.S. 753 (1992), this Court held that the anti-alienation provision of ERISA is "applicable nonbankruptcy law" within the meaning of Section 541(c)(2). 504 U.S. at 757-765. The bankruptcy court nonetheless concluded that Dr. Yates's interest in the plan was not excluded from his bankruptcy estate. The court reasoned that Dr. Yates, as the "self-employed owner of the professional corporation that sponsors the pension plan," "cannot participate as an employee under ERISA and he cannot use its provisions to enforce the restriction on the transfer of his beneficial interest" in the plan. Pet. App. 43a-44a (citing *SEC* v. *Johnston*, 143 F.3d 260 (6th Cir. 1998); *Fugarino* v. *Hartford Life & Accident Ins. Co.*, 969 F.2d 178 (6th Cir. 1992), cert. denied, 506 U.S. 966 (1993); and 29 C.F.R. 2510.3-3(c)(1)).

3. The United States District Court for the Eastern District of Tennessee affirmed the judgment of the bankruptcy court. Pet. App. 9a-35a. The district court considered itself bound by prior Sixth Circuit decisions that had held that neither a sole proprietor, *Fugarino*, *supra*, nor a sole shareholder of a corporate employer, *Agrawal* v. *Paul Revere Life Ins. Co.*, 205 F.3d 297 (2000), may be a participant in an ERISA plan. Pet. App. 15a-21a. Those decisions relied in significant part on a Department of Labor regulation, 29 C.F.R. 2510.3-3(c)(1), which the decisions interpreted to exclude sole owners and their spouses from the definition of "employee" for purposes of Title I of ERISA and therefore also from the definition of a plan "participant." See 29 U.S.C. 1002(6) (defining "employee" as "any individual employed by an employer"); 29 U.S.C. 1002(7) (defining "participant" as an "employee or former employee * * * who is or may become eligible to receive a benefit of any type from an employee benefit plan"). The district court acknowledged that the regulation is better read to address only which plans are covered by Title I of ERISA, and to permit sole owners to participate in ERISA plans that also cover other employees, as other circuits have held. Pet. App. 19a (citing *Madonia* v. *Blue Cross & Blue Shield*, 11 F.3d 444 (4th Cir. 1993), cert. denied, 511 U.S. 1019 (1994), and *Vega* v. *National Life Ins. Servs., Inc.*, 188 F.3d 287 (5th Cir. 1999)). But the court concluded that it was bound by Sixth Circuit precedent, under which Dr. Yates "was not qualified to participate in an ERISA protected plan." *Id.* at 20a.

4. The United States Court of Appeals for the Sixth Circuit affirmed the district court's judgment. Pet. App. 1a-8a. The court reasoned that the plan's anti-alienation clause is not "enforceable under applicable nonbankruptcy law" within the meaning of 11 U.S.C. 541(c)(2) because it "is not enforceable by Dr. Yates under ERISA." Pet. App. 6a.

The court of appeals noted that ERISA provides that "[a] civil action may be brought . . . by a participant, beneficiary, or fiduciary . . . to obtain . . . appropriate equitable relief . . . to enforce . . . the terms of the plan." Pet. App. 5a (quoting 29 U.S.C. 1132(a)(3)(b)(ii)). But the court reasoned that, under *Fugarino* and *Agrawal*, Dr. Yates, as a sole shareholder, "cannot qualify as a 'participant or beneficiary' in an ERISA pension plan." *Ibid.* Concluding that those circuit precedents dictate that Dr. Yates "does not have standing under the ERISA enforcement mechanisms," *ibid.* (quoting *Agrawal*, 205 F.3d at 302), the court held that "the spendthrift clause in the * * * plan is not enforceable by Dr. Yates under ERISA." *Id.* at 6a.

The full court subsequently denied a petition for rehearing en banc. Pet. App. 51a.

DISCUSSION

This Court's review is warranted to resolve a conflict among the courts of appeals on whether a working owner (such as a sole shareholder, sole proprietor, or partner who renders services to a business) may be a participant in an ERISA plan that also covers other employees. The court of appeals erroneously held that working owners who own the entire interest in a business are not eligible to participate in ERISA plans. This Court's intervention to correct the court of appeals' error is important because the question whether working owners may be participants in ERISA plans arises frequently and in a variety of contexts.

A. The Courts Of Appeals Are Divided On Whether Working Owners May Be Participants In ERISA Plans

1. ERISA seeks "to protect * * * the interests of participants in employee benefit plans and their beneficiaries." 29 U.S.C. 1001(b). Title I (29 U.S.C. 1001 *et seq.*) contains provisions, administered and enforced primarily by the Department of Labor, that govern reporting and disclosure, fiduciary responsibility, and plan administration and enforcement, as well as substantive requirements for group health plans. Title II, 88 Stat. 898 (codified in various provisions of Title 26 of the United States Code), contains amendments to Internal Revenue Code provisions governing when employee benefit plans qualify for favorable tax treatment. Title III (29 U.S.C. 1201 *et seq.*) contains miscellaneous administrative provisions, and Title IV (29 U.S.C. 1301 *et seq.*) requires the Pension Benefit Guaranty Corporation (PBGC) to guarantee benefits to participants in and beneficiaries of defined benefit pension plans.

Title I of ERISA defines a "participant" as "any employee or former employee of an employer, or any member or former member of an employee organization, who is or may become eligible to receive a benefit of any type from an employee benefit plan which covers employees of such employer or members of such organization, or whose beneficiaries may be eligible to receive any such benefit." 29 U.S.C. 1002(7). Title I defines a "beneficiary" as "a person designated by a participant, or by the terms of an employee benefit plan, who is or may become entitled to a benefit thereunder." 29 U.S.C. 1002(8). And Title I defines "employee" as "any individual employed by an employer." 29 U.S.C. 1002(6). Participants and beneficiaries are authorized to bring civil actions to enforce their rights under ERISA and ERISA plans. 29 U.S.C. 1132(a).[1]

2. There is a conflict among the circuits on whether sole shareholders who work for the corporations that they own may be participants in ERISA plans that cover them and other employees of the corporations. The courts of appeals have also taken divergent approaches in deciding whether working owners of other business forms, such as sole proprietorships and partnerships, may be participants in ERISA plans.

The First and Sixth Circuits have held that a sole shareholder may not be a "participant" in a plan covered by Title I of ERISA. See *Kwatcher* v. *Massachusetts Serv. Employees Pension Fund*, 879 F.2d 957 (1st Cir. 1989); *Agrawal* v. *Paul Revere Life Ins. Co.*, 205 F.3d 297 (6th Cir. 2000); Pet. App. 1a-8a. In direct conflict, the Fourth and Fifth Circuits have held that a sole shareholder may be a participant. *Madonia* v. *Blue Cross & Blue Shield*, 11 F.3d 444 (4th Cir. 1993), cert. denied, 511 U.S. 1019 (1994); *Vega* v. *National Life Ins. Servs., Inc.*, 188 F.3d 287 (5th Cir. 1999).

Although the question presented in the certiorari petition does not appear to encompass the issue, see Pet. i, there is also a conflict among the circuits on whether a sole shareholder may be a "beneficiary" of an ERISA plan. The Sixth Circuit, in *Agrawal* and in this case, has held that a sole shareholder may not be designated as a beneficiary, while the Eighth and Eleventh Circuits have held that a sole shareholder may be designated as a beneficiary. *Robinson* v. *Linomaz*, 58 F.3d 365 (8th Cir. 1995); *Gilbert* v. *Alta Health & Life Ins. Co.*, 276 F.3d 1292 (11th Cir. 2001).[2]

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[1] Plan fiduciaries are also authorized to bring civil actions to enforce the terms of ERISA and ERISA plans. 29 U.S.C. 1132(a)(3).

[2] Several circuits (including the Sixth) have addressed coverage of other substantial or controlling shareholders and have uniformly held that such shareholders may participate in ERISA plans sponsored by their

Regarding other types of working owners, the Sixth and Seventh Circuits have held that sole proprietors may not be participants in ERISA plans. *Fugarino* v. *Hartford Life & Accident Ins. Co.*, 969 F.2d 178 (6th Cir. 1992), cert. denied, 506 U.S. 966 (1993); *Giardono* v. *Jones*, 867 F.2d 409 (7th Cir. 1989). In dicta, the Tenth Circuit has expressed its agreement with that view, *Peckham* v. *Board of Trustees*, 653 F.2d 424, 427-428 (1981), and the Second Circuit has expressed its disagreement, *Schwartz* v. *Gordon*, 761 F.2d 864, 869 (1985). The Third and Ninth Circuits have held that partners may be beneficiaries of ERISA plans. *Wolk* v. *UNUM Life Ins. of Am.*, 186 F.3d 352 (3d Cir. 1999), cert. denied, 528 U.S. 1076 (2000); *Peterson* v. *American Life & Health Ins. Co.*, 48 F.3d 404 (9th Cir.), cert. denied, 516 U.S. 942 (1995); *Harper* v. *American Chambers Life Ins. Co.*, 898 F.2d 1432 (9th Cir. 1990). But the Ninth Circuit has stated, in dictum, that partners may not be participants. *Peterson*, 48 F.3d at 408; *Harper*, 898 F.2d at 1434.[3]

Although the foregoing cases involving sole proprietors and partners have not yet generated a conflict, they reflect the same divergence in approach to the treatment of working owners that has produced the conflict regarding sole shareholders. This Court's resolution of the conflict regard-

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corporate employers. *Leckey* v. *Stefano*, 263 F.3d 267 (3d Cir. 2001); *Santino* v. *Provident Life & Accident Ins. Co.*, 276 F.3d 772 (6th Cir. 2001); *In re Baker*, 114 F.3d 636 (7th Cir. 1997); *Prudential Ins. Co. of Am.* v. *Doe*, 76 F.3d 206 (8th Cir. 1996); *Sipma* v. *Massachusetts Cas. Ins. Co.*, 256 F.3d 1006 (10th Cir. 2001); *Engelhardt* v. *Paul Revere Life Ins. Co.*, 139 F.3d 1346 (11th Cir. 1998).

[3] The remaining cases cited by petitioners (Pet. 8) as evidencing a circuit conflict address whether particular plans are covered by Title I of ERISA, not whether working owners can be participants in covered plans. *LaVenture* v. *Prudential Ins. Co. of Am.*, 237 F.3d 1042 (9th Cir. 2001); *Slamen* v. *Paul Revere Life Ins. Co.*, 166 F.3d 1102 (11th Cir. 1999); *In re Watson*, 161 F.3d 593 (9th Cir. 1998); *Schwartz* v. *Gordon*, 761 F.2d 864 (2d Cir. 1985).

ing sole shareholders would therefore likely provide substantial assistance in resolving the broader uncertainty and confusion concerning the treatment of working owners generally.

B. The Court Of Appeals' Holding That Working Owners Are Precluded From Being Participants In ERISA Plans Is Erroneous

This Court's review is also warranted because the court of appeals' decision in this case is incorrect. Without analyzing the issue independently, that court followed circuit precedent and held that "a sole shareholder cannot qualify as a 'participant or beneficiary' in an ERISA pension plan." Pet. App. 5a. That holding disregards the guidance provided by this Court's decision in *Nationwide Mutual Insurance Co.* v. *Darden*, 503 U.S. 318 (1992), and the text of ERISA, and it conflicts with an advisory opinion issued by the Department of Labor and misinterprets a Department of Labor regulation.

1. In *Darden*, this Court addressed whether an insurance salesman was a "participant" under Title I of ERISA in a retirement plan sponsored by the insurance company whose policies the agent sold. The Court explained that generally an individual can qualify as a "participant" only if the individual is an "employee," which ERISA defines as "any individual employed by an employer." 503 U.S. at 320-321 (quoting 29 U.S.C. 1002(6) and (7)). Finding the latter definition "completely circular," the Court looked elsewhere to determine whether the salesman was an "employee" or was instead an independent contractor. *Id.* at 323. Because the Court could not find "any provision [in ERISA] either giving specific guidance" on how to differentiate between an employee and an independent contractor or suggesting that adopting the traditional common-law test to distinguish between the two categories "would thwart the congressional

design or lead to absurd results," the Court adopted the common-law test. *Ibid.*

The precise question in *Darden* was different from the question presented here. The question in *Darden* was whether someone who provides services to a business in exchange for remuneration is precluded from being a "participant" in an ERISA plan because he is an independent contractor. Here, the question is whether someone who provides services to a business in exchange for remuneration is precluded from being a "participant" because he is the business's owner. Nonetheless, *Darden* sets forth the appropriate mode of analysis for resolving the question presented here. The first step is to determine whether any provisions of ERISA itself furnish guidance on whether the working owner of a business may be a plan participant. If the statutory text provides no guidance, then common-law principles should be used to resolve the question, provided their application would not thwart the congressional design or lead to irrational consequences.

2. There is no need to proceed beyond the first step in this case because Title I of ERISA contains several provisions that plainly contemplate that working owners may be participants in employee benefit plans. For example, Title I generally requires that all assets in covered plans be held in trust. 29 U.S.C. 1103(a). But 29 U.S.C. 1103(b)(3)(A) exempts from that requirement (subject to certain qualifications) a plan "some or all of the *participants* of which are *employees* described in section 401(c)(1) of [the Internal Revenue Code]" (emphasis added). Section 401(c)(1) provides that the term "employee," for purposes of Section 401 (which prescribes the criteria under which pension plans qualify for favorable tax treatment), includes a "self-employed individual." 26 U.S.C. 401(c)(1)(A). That term is in turn defined as a person with "earned income" from "a trade or business in which personal services of the taxpayer

are a material income-producing factor," a definition that includes sole proprietors and partners. See 26 U.S.C. 401(c)(1)(B) and (2)(A)(i), 1402(a) and (c). The exemption from the trust requirements under Title I of ERISA would be meaningless unless working partners and sole proprietors may be participants in ERISA plans.

ERISA's prohibited transaction provisions also contemplate that working owners may be plan participants. ERISA generally prohibits transactions between a plan and a party in interest, 29 U.S.C. 1106, but contains an exemption for loans to plan participants that meet certain conditions. One condition is that the loans not discriminate in favor of "highly compensated employees (within the meaning of section 414(q) of [the Internal Revenue Code])." See 29 U.S.C. 1108(b)(1)(B). A "highly compensated employee" includes "any employee" who owns more than five percent of the stock of a corporate employer or more than a five percent interest in a non-corporate employer. 26 U.S.C. 414(q)(1)(A) and (2); 26 U.S.C. 416(i)(1)(B)(i). Furthermore, 29 U.S.C. 1108(d)(1) excludes from the participant loan exemption an "owner-employee" as defined in Section 401(c)(3) of the Internal Revenue Code. An "owner-employee" means an employee who is either a sole proprietor or a partner who owns more than 10% of the partnership. 26 U.S.C. 401(c)(3). Thus, the participant loan provisions treat shareholders, sole proprietors, and partners as potential plan participants.

That reading of Title I of ERISA is reinforced by related statutory provisions. Most notably, ERISA was enacted against a background of Internal Revenue Code provisions that permitted and continue to permit working owners (including sole shareholders, sole proprietors, and partners) to participate in pension plans that meet the qualifications for favorable tax treatment, including that the plans be "for the exclusive benefit of * * * employees." 26 U.S.C. 401(a). See, *e.g.*, 26 U.S.C. 401(c) (1970 and 2000) ("employee" under

Section 401 includes "self-employed individuals," including "owner-employees"); 26 C.F.R. 1.401-1(b)(3) (1973 and 2002) ("Among the employees to be benefited may be persons who are officers and shareholders."); Rev. Rul. 72-4, 1972-1 C.B. 105 (pension plan that benefits "principal or sole shareholder" may qualify under 26 U.S.C. 401(a)). Indeed, corporate shareholders who are employees have been treated as "employees" eligible to participate in tax-qualified pension plans since 1942. Revenue Act of 1942, ch. 619, 56 Stat. 862 (former 26 U.S.C. 165(a)(4)); see S. Rep. No. 992, 87th Cong., 1st Sess. 8-9 (1961). And, in 1962, Congress enacted the Self-Employed Individuals Tax Retirement Act, Pub. L. No. 87-792, 76 Stat. 809, authorizing the creation of "Keogh" plans for partners and sole proprietors, for the specific purpose of giving "self-employed persons access to retirement plans on a reasonably similar basis to that accorded corporate shareholder employees." S. Rep. No. 992, *supra*, at 8.

The plan termination insurance provisions in Title IV of ERISA also expressly contemplate participation by working owners in ERISA plans. Title IV generally applies to any employee pension benefit plan, as defined in 29 U.S.C. 1002(2), that is not an individual account plan and that meets specified requirements in the Internal Revenue Code, including qualification under Section 401(a). 29 U.S.C. 1321(a)-(c). Title IV excepts from its coverage any plan "established and maintained exclusively for substantial owners," 29 U.S.C. 1321(b)(9), which include sole proprietors, and partners and shareholders with an ownership interest of more than 10%, 29 U.S.C. 1322(b)(5)(A). Plans in which substantial owners participate along with other employees are, however, generally covered by Title IV. See 29 U.S.C. 1322(b)(5)(B) (limiting amount of benefits that PBGC will guarantee to substantial owners who participate in single-employer plans).[4]

These statutory provisions reveal a clear congressional intent to include working owners within the definition of "participant" under Title I of ERISA. The alternative—that working owners may participate in tax-qualified pension plans under the Internal Revenue Code, and even have some of their pension benefits guaranteed by the PBGC, but have no enforceable rights under Title I—would make scant sense. Working owners would be encouraged through the receipt of tax benefits to participate in ERISA plans with other employees but would have different rights and remedies than those of other participants under the same plan. See pp. 17-18, *infra*. The PBGC would be required to guarantee pension benefits to persons who are not plan participants under Title I and thus do not have the tools that Title provides to protect their rights, a situation that could shift costs from the private pension system to the federal government for no discernible policy reason. Those are just the kind of "absurd results" this Court warned against in *Darden*. 503 U.S. at 323.[5]

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[4] Title IV also excepts from its coverage plans with 25 or fewer active participants that are "established and maintained by a professional service employer." 29 U.S.C. 1321(b)(13). A "professional service employer" includes a professional corporation of the type involved in this case. 29 U.S.C. 1321(c)(2). The inclusion of this exception indicates that such plans would otherwise be covered by Title IV.

[5] Because the text of ERISA demonstrates that a working owner may be a participant in an ERISA plan, there is no cause to resort to the common law. See *Darden*, 503 U.S. at 323. This Court's recent decision in *Clackamas Gastroenterology Assocs.*, *P.C.* v. *Wells*, 123 S. Ct. 1673 (2003), therefore provides little assistance in resolving the question presented here. In *Clackamas*, the Court endorsed the Equal Employment Opportunity Commission's test, drawn from common-law principles, for determining whether partners and major shareholders are employees under the Americans with Disabilities Act of 1990 (ADA), 42 U.S.C. 12101 *et seq.*, since the text of the ADA was silent on how to resolve that question.

3. Based on the above considerations, the Department of Labor has concluded in an advisory opinion that working owners may be "participants" within the meaning of Title I of ERISA. See Pension & Welfare Benefits Admin., U.S. Dep't of Labor, Advisory Opinion No. 99-04A (Feb. 4, 1999) (*reprinted in* App., *infra*, 1a-9a). That opinion of the agency charged by Congress with the administration of Title I of ERISA reflects a "body of experience and informed judgment to which the courts and litigants may properly resort for guidance." *Skidmore* v. *Swift & Co.*, 323 U.S. 134, 140 (1944).

Although petitioners alerted the court of appeals to the advisory opinion, the court did not discuss it. Instead, the court followed its own prior opinion, which had placed significant reliance on a Department of Labor regulation, 29 C.F.R. 2510.3-3(c)(1). See Pet. App. 5a-6a (citing *Fugarino*, 969 F.2d at 186). That prior opinion, like the decision of the other court of appeals that has held that sole shareholders may not be ERISA plan participants, misconstrued the regulation. Those cases mistakenly read the regulation as providing a general definition of the statutory term "employee" that excludes sole shareholders, thereby precluding them from being plan participants. See *ibid.*; *Kwatcher*, 879 F.2d at 961-962; see also *Giardono*, 867 F.2d at 412. Contrary to that reading, as explained by the courts of appeals that have held that sole shareholders may be plan participants, the regulation does not define the statutory term "employee." Nor does it identify who is eligible to be a "participant" in a plan covered by ERISA. Rather, the regulation addresses what plans are covered by Title I of ERISA in the first

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Because resolution of the question presented here turns on the text of ERISA, rather than common-law principles, there is no reason for the Court to grant, vacate, and remand this case in light of *Clackamas*.

place. See *Vega*, 188 F.3d at 294; *Madonia*, 11 F.3d at 449-450; see also *Gilbert*, 276 F.3d at 1302-1303.

The regulation as a whole is entitled "employee benefit plan," and its numbering, Section 2510.3-3, corresponds to Section 3(3) of ERISA, 29 U.S.C. 1002(3), the statutory definition of the term "employee benefit plan." Subsection (a) of the regulation explains its scope: it "clarifies the definition in section 3(3) of the term 'employee benefit plan' for purposes of title I of the Act." 29 C.F.R. 2510.3-3(a). Subsection (b) of the regulation, entitled "[p]lans without employees," provides that "the term 'employee benefit plan' shall not include any plan, fund or program, other than an apprenticeship or other training program, under which no employees are participants covered under the plan." 29 C.F.R. 2510.3-3(b). It explains, for example, that, although a "Keogh" or "H.R. 10" plan covering only partners or a sole proprietor will not be covered under Title I, "a Keogh plan under which one or more common law employees, in addition to the self-employed individuals, are participants covered under the plan, will be covered under title I." 29 C.F.R. 2510.3-3(b). Subsection (c) of the regulation is entitled "Employees" and states:

> For purposes of this section [*i.e.*, for purposes of the regulation defining a covered plan]:
>
> (1) An individual and his or her spouse shall not be deemed to be employees with respect to a trade or business, whether incorporated or unincorporated, which is wholly owned by the individual or by that individual and his or her spouse, and
>
> (2) A partner in a partnership and his or her spouse shall not be deemed to be employees with respect to the partnership.

29 C.F.R. 2510.3-3(c)(1) and (2).

The regulation thus excludes from Title I coverage plans whose only participants are sole owners or partners and their spouses. Subsection (c) identifies who may not be deemed an "employee" only for purposes of the regulation itself. It does not exclude sole owners or partners from the *statutory* definition of "employee" or from being participants in plans that also cover one or more employees who are not sole owners or partners and their spouses. To the contrary, the regulation makes clear that a "*plan under which* one or more common law employees, in addition to the *self-employed individuals*, *are participants* covered under the plan, *will be covered under title I*." 29 C.F.R. 2510.3-3(b) (emphasis added).[6]

4. The courts of appeals that have denied participant status to working owners have also mistakenly relied on ERISA's "anti-inurement" provision, 29 U.S.C. 1103(c)(1). That provision, those courts have reasoned, is transgressed if an owner is also a participant because then the owner, as a participant, may benefit from plan assets. See *Fugarino*, 969 F.2d at 186; *Kwatcher*, 879 F.2d at 959-960; *Giardono*, 867 F.2d at 411. The anti-inurement provision, however, does not preclude coverage of working owners as plan participants. It states that, with enumerated exceptions, "the assets of a plan shall never inure to the benefit of any employer and shall be held for the exclusive purposes of providing benefits to participants in the plan and their beneficiaries and defraying reasonable expenses of admin-

[6] The fact that the regulation does not provide a general definition of "employee" was made even more explicit in the regulatory preamble. The preamble explained that, in the proposed rules, the definition of "employee" had been located in 29 C.F.R. 2510.3-6 and had defined "employee" for all purposes under Title I, but comments had raised concerns about the implications of a general definition for other provisions in ERISA. In response, "the definition of 'employee' formerly appearing in proposed § 2510.3-6 [was] inserted into § 2510.3-3 and restricted in scope to that section." 40 Fed. Reg. 34,528 (1975).

istering the plan." 29 U.S.C. 1103(c)(1). Accordingly, the provision expressly permits paying benefits to plan participants; it does not answer the separate question whether working owners can be plan participants under ERISA. Indeed, the anti-inurement provision in Title I of ERISA is based on the analogous exclusive benefit provision in the Internal Revenue Code, 26 U.S.C. 401(a)(2), which does not bar plan participation by working owners. See H.R. Conf. Rep. No. 1280, 93d Cong., 2d Sess. 302-303 (1974); pp. 11-12, *supra*. The purpose of the anti-inurement provision, like ERISA's other fiduciary provisions, is to apply the law of trusts to discourage abuses such as self-dealing, imprudent investment, and misappropriation of plan assets. See, *e.g.*, *Prudential Ins. Co. of Am.* v. *Doe*, 76 F.3d at 209. Those concerns are not implicated by paying benefits to working owners who participate on an equal basis in plans protected by other ERISA safeguards.

C. The Question Presented Is Important And Should Be Resolved By This Court

It is important for this Court to correct the error of the court of appeals because the question presented not only has divided the courts of appeals but also affects the rights and duties of ERISA actors in many contexts. Often, for example, the working owner of a small business who has purchased health or disability insurance for himself and his employees sues the insurance company for denying the owner's personal benefit claim. See, *e.g.*, *Wolk*, *Madonia*, *Vega*, *Fugarino*, *Agrawal*, *Robinson*, *Peterson*, *Gilbert*, *supra*. The owner seeks state law remedies, the insurer invokes ERISA preemption, and the owner claims to be outside the ERISA plan. Courts, such as the Sixth Circuit, that have permitted the owner to split the plan in that manner have concluded that the owner retains his state law remedies, while his employees are limited to what are generally narrower remedies under ERISA. See, *e.g.*, *Fugarino*, 969 F.2d at 186. That anomalous result defeats two purposes of ERISA: to "ensure[] that the administrative practices of a benefit plan will be governed by only a single set of regulations," *Fort Halifax Packing Co.* v. *Coyne*, 482 U.S. 1, 11 (1987), and to "ensure[] similar treatment for all claims relating to employee benefit plans." *Madonia*, 11 F.3d at 450.

In other contexts, such as the one presented by this case, the owner seeks to be recognized as an ERISA participant to gain protections that the owner contends are provided by ERISA, here the protection against alienation of pension benefits. See, *e.g.*, *Kwatcher*, *supra* (sole shareholder suing for benefits from multi-employer plan). In those contexts as well, the Sixth Circuit's rule leads to the anomalous situation in which participants in a single plan have different rights and remedies. Moreover, to the extent that the decisions holding that working owners are not ERISA plan participants also stand for the proposition that the plans themselves have two separate components, one covered by ERISA and the other not covered, the result is even more impracticable. Under the Internal Revenue Code, a pension plan is either tax-qualified or it is not; it is not meaningful to describe a plan as tax-qualified in part. The same is true under Title I of ERISA. Title I requirements, such as the duty to hold plan assets in trust and to manage those assets in accordance with ERISA fiduciary duties, apply to all the assets of the plan. Indeed, in traditional defined benefit plans, in which plan assets are not held in individual accounts, it is impossible to apply ERISA fiduciary duties to only that portion of plan assets earmarked for employees other than working owners.

As noted above, a number of courts have tried to avoid treating working owners and their employees differently under ERISA by allowing the owners to be classified as

ERISA "beneficiar[ies]" under 29 U.S.C. 1002(8). See pp. 7-8, *supra* (citing *Robinson*, *Gilbert*, *Wolk*, *Peterson*, and *Harper*). Those courts reason that ERISA's definition of beneficiary is broad enough on its face to include any "person designated * * * by the terms of an employee benefit plan[] who is or may become entitled to a benefit" under the plan. 29 U.S.C. 1002(8); see, *e.g.*, *Harper*, 898 F.2d at 1434.

That approach, however, has two fundamental flaws. First, it has no logical stopping point: anyone could be "designated * * * by the terms of an employee benefit plan" as a beneficiary, even when that person lacks any employment nexus with the plan sponsor. For instance, in *Hollis* v. *Provident Life & Accident Insurance Co.*, 259 F.3d 410, 415 (5th Cir. 2001), cert. denied, 535 U.S. 986 (2002), the court held that an independent contractor could be designated as a "beneficiary" under an ERISA plan, a result that is in considerable tension with this Court's decision in *Darden* that an independent contractor cannot be a plan "participant." Second, the "beneficiary" theory would enable working owners to assert rights only under welfare plans, and not under pension plans, because the ERISA provisions that govern pension rights use the terms "employee" and "participant," but not the term "beneficiary." See 29 U.S.C. 1052, 1053, 1054. Although a participant in a pension plan may have a beneficiary, such as a surviving spouse, pension credits can only be earned on work performed by an employee; the entitlement of the beneficiary is purely derivative. See 29 U.S.C. 1055; *Boggs* v. *Boggs*, 520 U.S. 833, 846-847 (1997). Thus, the only way to avoid the anomalous results produced by the court of appeals' rule is to reject it.[7]

[7] Respondent argues (Br. in Opp. 9) that this Court should decline review because there are alternative rationales under which the court of appeals could have reached the same judgment. Neither the district court nor the court of appeals relied on the alternative rationales advanced by respondent, however, and it is not certain that either of those courts

CONCLUSION

The Court should grant the petition for a writ of certiorari.

Respectfully submitted.

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MAY 2003

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would accept them. The possibility that the court of appeals might arrive at the same judgment after a remand is not a reason for this Court to decline to resolve the important circuit conflict that is squarely presented by the court of appeals' actual decision. See, *e.g.*, Reply Br. at 6, 10 n.4, *Clay* v. *United States*, cert. granted, 536 U.S. 957 (2002) (No. 01-1500); Reply Br. at 1-5, *United States* v. *Bean*, cert. granted, 534 U.S. 1112 (2002) (No. 01-704); Br. Amicus Curiae for the United States at 20, *Edelman* v. *Lynchburg College*, cert. granted, 533 U.S. 928 (2001) (No. 00-1072).

APPENDIX

U.S. Department of Labor

Pension and Welfare Benefits Administration
Washington, D.C. 20210

[seal omitted]

Feb. 4, 1999

John P. Counts, Esq.	99-04A
David Potts-Dupre, Esq.	ERISA SEC.
Counts & Kanne	3(7)
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Washington, D.C. 20005	

Dear Messrs. Counts and Potts-Dupre:

This is in response to your request for an advisory opinion containing the definition of "participant" provided in section 3(7) of Title I of the Employee Retirement Income Security Act of 1974 (ERISA). Specifically, you ask whether individuals who own business enterprises, either wholly or in part, and who provide personal services to those businesses may be "participants," within the meaning of section 3(7) of ERISA, in a multiemployer employee benefit plan. You state that the business enterprises that are the subject of this request include businesses that are operated as corporations, sole proprietorships, and partnerships.

You submit your request on behalf of the National Electrical Benefit Fund (the NEBF), a multiemployer pension plan established jointly by the International Brotherhood of Electrical Workers (IBEW) and the National Electrical Contractors Association (NECA) pursuant to collective bargaining. You describe the NEBF as the largest construction industry fund in the United States, with approximately 375,000 participants, over 14,000 contributing employers, and plan assets of almost five billion dollars.

The documents that you have submitted indicate that an individual can become eligible to participate in the NEBF only as a result of an employer's having executed a participation agreement with the NEBF, obligating the employer to make contributions on behalf of at least some of its employees. *See* Restated Employees Benefit Agreement and Trust for the National Electrical Benefit Fund (hereinafter Trust Agreement), Part I, Provision 4; sections 1.7, 1.8, 1.18, 6.3.3. An employer must agree at a minimum to make contributions on behalf of its bargaining unit employees. *Id.* section 6.3.1. Such an employer may elect, in addition, to contribute on behalf of its "non-bargaining unit employees." An employer may contribute on behalf of all "non-bargaining unit employees" or only those non-bargaining unit employees who were formerly bargaining unit members ("alumni"). *Id.*

With respect to bargaining unit employees, a participating employer must contribute to the NEBF an amount equal to three percent of "all wages and other compensation paid to, or accrued by, the Covered Employees in the . . . bargaining unit for services performed for the Covered Employer." *Id.* section 6.2.1. For non-bargaining unit employees, the employer must contribute to the NEBF an amount equal to the lesser of

> "(a) 3% of all wages and other compensation which the Covered Employer would pay, or which the [non-bargaining unit] Covered Employees would accrue, if the Covered Employees were receiving the wage rate received by the highest number of employees in the appropriate . . . bargaining unit and working the

> normal straight time hours provided for in the appropriate labor agreement, or (b) 3% of all wages and other compensation paid to, or accrued by, the [non-bargaining unit] Covered Employees for services performed for the Covered Employer. . . ."

Id. Section 6.2.2.

The documents that you have supplied indicate that the NEBF provides a pension benefit, which may be paid as an early retirement pension or a normal retirement pension, and a disability benefit. A participant becomes vested in his or her pension benefit upon earning at least five vesting service credits.[1] Pension benefits for vested participants are calculated by multiplying the participant's benefit service credits[2] by fixed dollar amounts that are specified in the plan. As a result, the amount of a participant's monthly pension benefit is not dependent upon the participant's actual income prior to retirement or the actual amount of contributions that an employer made on his or her behalf, but rather upon seniority in the NEBF.

You represent that the trustees of the NEBF currently interpret its plan documents to permit "working owners"[3] to be treated as employees eligible to participate in the NEBF

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[1] One vesting service credit is earned for each year after 1965 in which a participant is credited with 1000 hours of covered service for covered employment (employment during a period for which an employer is obligated to make contributions for that employee).

[2] One benefit service credit is similarly earned for each year after 1965 in which a participant is credited with 1000 hours of covered employment.

[3] By the term "working owner," you apparently mean an individual who has an equity ownership right of any nature in a business enterprise and who is actively engaged in providing services to that business, as distinguished from a "passive" owner, who may own shares in a corporation, for example, but is not otherwise involved in the activities in which the business engages for profit.

and therefore to become participants in the NEBF.[4] The eligible "working owners" include any "owner that earns wages or self-employment income from a company," including sole proprietors of unincorporated businesses. You indicate that the working owners who currently participate in the NEBF are journeyman electricians who had worked initially as bargaining unit members for other employers that contributed to the NEBF on their behalf. They subsequently acquired ownership interests in those employers or started their own electrical businesses, sometimes in partnership with other similarly situated individuals, sometimes by creating wholly-owned corporations, and sometimes operating as sole proprietors. They continue to work as electricians and in some cases employ other union members covered by the NEBF. Most of these working owners had earned vested pension benefits in the NEBF based on their previous service as bargaining unit employees, and they began accruing additional service credits when the NEBF changed its eligibility rules in 1994 to permit working owners to participate.

You represent that the employer's payroll reports, submitted monthly to the NEBF, are used to determine an employer's contributions, based on the working owner's reported "wages," and a working owner's service credits, based on the working owner's reported hours of service. You further represent that reporting employers determine a working owner's "wages" by determining the greater of the working owner's actual gross earnings subject to employment tax for that month or the amount the working

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[4] This current practice has been followed only since January, 1994. In the course of its history (since its creation in the early 1960's), the NEBF's practices have varied regarding participation by individuals who have equity ownership rights in business enterprises that operate in the industry covered by the IBEW.

owner would have earned if he had worked at normal straight-time hours for the month at the applicable journeyman's rate. The working owner's hours of service are reported as the actual hours the working owner worked for the business during the month.

Section 3(7) of Title I of ERISA provides that a "participant" is "any employee or former employee of an employer, or any member or former member of an employee organization, who is or may become eligible to receive a benefit of any type from an employee benefit plan which covers employees of such employer or members of such organization, or whose beneficiaries may be eligible to receive any such benefit." Section 3(6) in turn defines an "employee" as "any individual employed by an employer." Finally, section 3(5) defines "employer" as "any person acting directly as an employer, or indirectly in the interest of an employer, in relation to an employee benefit plan; and includes a group or association of employers acting for an employer in such capacity."

Title I of ERISA contains multiple indications, albeit indirect, that Congress assumed that a "working owner" could be a "participant" in an employee benefit plan sponsored by the business in which that working owner held an ownership right, regardless of the legal form in which the business was operated. For example, section 401(a)(2) exempts certain partnership agreements from the fiduciary provisions of Part 4. This exemption would be meaningless if the partnership agreements themselves (which cover only partners, one of the categories of "working owners") were not otherwise plans covered by Title I. Further, section 403(b)(3)(A) specifically exempts from the trust requirement of section 403(a) a plan "some or all of the *participants* of which are employees described in section 401(c)(1) of the Code [emphasis added]." This exemption takes as its basis the assumption that the employees described in Code section 401(c)(1), namely self-employed individuals (including "working owners"), are legitimate "participants" within the meaning of Title I. Also, section 408(b)(1) exempts from section 406's prohibition of specified transactions certain nondiscriminatory loans made to plan participants, including highly compensated employees, but section 408(d)(1) eliminates that exemption for owner-employees as defined in section 401(c)(3) of the Code. Inasmuch as the owner-employers described in Code section 401(c)(3) are sole proprietors and more than ten-percent partners, it is clear that the provisions in section 408 of Title I assume that such "working owners" are "participants" in the plans from which those loans would be made.

The indications of Congressional intent are supported and reinforced by the treatment of "working owners" under the provisions of Title II and Title IV of ERISA.[5] Section 401(c) of the Internal Revenue Code (the Code) provides that self-employed individuals are included as "employees" under Code section 401(a) to the extent that they have earned income "with respect to a trade or business in which personal services of the [individual] are a material income-producing factor." Code section 401(c)(2)(A). Code section 401(c) further imposes specific additional requirements on tax-qualified pension plans that provide benefits to "owner-employees," a term defined in Code section 401(c)(3) to include employees who own the entire interest in an unincorporated trade or business or more than 10 percent of a partnership. It is thus patently clear that Title II of ERISA

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[5] Although we rely on certain provisions of Title II and Title IV in reaching the conclusions expressed in this opinion, nothing in this opinion should be construed as interpreting the provisions of those Titles that lie within the interpretive jurisdiction of the Department of the Treasury and the Pension Benefit Guaranty Corporation.

permits "working owners" to receive the tax benefits that flow from participation as "participants" in pension plans that meet the qualification requirements of Code section 401(a).

Title IV of ERISA (the termination insurance provisions) also expressly includes "working owners" among the "participants" who receive its protections. *See* ERISA section 4001(b)(1) ("[a]n individual who owns the entire interest in an unincorporated trade or business is treated as his own employer, and a partnership is treated as the employer of each partner who is an employee within the meaning of [Code] section 401(c)(1). . ."). Section 4021(b)(9) of ERISA excludes from coverage under Title IV only those pension plans that are "established and maintained exclusively for substantial owners," i.e., sole proprietors and more than ten-percent owners of partnerships and corporations. *See* ERISA section 4022(b)(5)(A) (defining "substantial owner"). Title IV limits the amount of benefits that the PBGC guarantees to "substantial owners" who participate in single employer plans, but nonetheless provides a basic guarantee of such owners' pension benefits. Such a guarantee would be meaningless if Title I did not permit such owners to be participants in ERISA-covered pension plans.

In our view, the statutory provisions of ERISA, taken as a whole, reveal a clear Congressional design to include "working owners" within the definition of "participant" for purposes of Title I of ERISA. Congress could not have intended that a pension plan operated so as to satisfy the complex tax qualification rules applicable to benefits provided to "owner-employees" under the provisions of Title II of ERISA, and with respect to which an employer faithfully makes the premium payments required to protect the benefits payable under the plan to such individuals under Title IV of ERISA, would somehow transgress against the limitations of the definitions contained in Title I of ERISA. Such a result would cause an intolerable conflict between the separate titles of ERISA, leading to the sort of "absurd results" that the Supreme Court warned against in *Nationwide Mutual Insurance Co.* v. *Darden*, 503 U.S. 318 (1992).[6]

Therefore, it is the view of the Department that there is nothing in the definitions of Title I of ERISA that would preclude a pension plan, including the NEBF, from extending plan coverage to "working owners," as described in your submission, where such coverage is otherwise consistent with the documents and instruments governing the plan and does not violate any other provisions of Title I.[7]

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[6] In *Darden*, the United States Supreme Court held that the definition of "employee" provided in section 3(6) of Title I did not include an individual who was an independent contractor to the employer that established and maintained the plan. In reaching this conclusion, the Court first sought to determine whether ERISA contained any provision "either giving specific guidance on the term's meaning or suggesting that construing it to incorporate traditional agency law principles would thwart the congressional design or lead to absurd results." *Id.* at 323. Finding no guidance in the statute itself, the Court concluded that, "[w]here Congress uses terms that have accumulated settled meaning under . . . the common law, a court must infer, unless the statute otherwise dictates, that Congress means to incorporate the established meaning of these terms." 503 U.S. at 322. We follow here the Court's analysis in *Darden*, although with a different result, inasmuch as we find ample guidance in ERISA as to Congress' specific intent to treat "working owners" as "participants."

[7] In its regulation at 29 C.F.R. 2510.3-3, the Department clarified that the term "employee benefit plan" as defined in section 3(3) of Title I does not include a plan the only participants of which are "[a]n individual and his or her spouse . . . with respect to a trade of business, whether incorporated or unincorporated, which is wholly owned by the individual or by the individual and his or her spouse" or "[a] partner in a partnership and his or her spouse." The regulation further specifies, however, that a plan that covers as participants "one or more common law employees, in addition to the self-employed individuals" will be included in the definition of "employee benefit plan" under section 3(3). The conclusion of this opinion, that such "self-employed individuals" are themselves "participants" in the covered plan, is fully consistent with that regulation.

ERISA's fiduciary standards, however, require compliance with any other applicable federal law. Pursuant to ERISA section 514(d), nothing in Title I of ERISA shall be construed to alter, amend, modify, invalidate, impair, or supersede any federal law or any rule or regulation issued pursuant to such federal law. Such federal laws include any requirements applicable to multiemployer benefit plans under the Labor Management Relations Act (LMRA). Several federal courts interpreting the LMRA have upheld decisions by plan trustees to exclude owner-employees on the ground that their inclusion would violate the LMRA. *See, e.g.*, *Todd* v. *Benal Concrete Const. Co., Inc.*, 710 F.2d 581 (9th Cir. 1983); *Aitken* v. *GCU-Employer Retirement Fund*, 604 F.2d 1261 (9th Cir. 1979). The Department is not authorized to issue opinions regarding the LMRA. Accordingly, the fiduciary of a plan subject to the LMRA that includes "working owners" should seek legal advice regarding the propriety of the participation of "working owners" in such plans under the LMRA.

This letter constitutes an advisory opinion under ERISA Procedure 76-1. Accordingly, it is issued subject to the provisions of that procedure, including section 10 thereof relating to the effect of advisory opinions.

Sincerely,

Susan G. Lahne
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