

1977

ERISA's "Bad Boy": Forfeiture for Cause in Retirement Plans

John W. Lee

William & Mary Law School, jwleex@wm.edu

Repository Citation

Lee, John W., "ERISA's "Bad Boy": Forfeiture for Cause in Retirement Plans" (1977). *Faculty Publications*. 621.
<https://scholarship.law.wm.edu/facpubs/621>

Copyright c 1977 by the authors. This article is brought to you by the William & Mary Law School Scholarship Repository.
<https://scholarship.law.wm.edu/facpubs>

ERISA's "Bad Boy": Forfeiture For Cause In Retirement Plans

JOHN W. LEE*

INTRODUCTION

Prior to the enactment of the Employee Retirement Income Security Act of 1974 (ERISA),¹ retirement plans² frequently contained "bad boy" clauses which denied former plan participants their otherwise nonforfeitable retirement benefits if they were discharged for cause³ or if they competed with their former employer after termination of employment.⁴ Although the Internal Revenue Service speci-

* Partner with the firm of Hirschler, Fleischer, Weinberg, Cox & Allen in Richmond, Virginia. A.B., University of North Carolina, 1965; LL.B., University of Virginia, 1968; LL.M., Georgetown University, 1970.

1. Employee Retirement Income Security Act of 1974 (ERISA), Pub. L. No. 93-406, 88 Stat. 829 (1974) (codified in scattered sections of 5, 18, 26, 31, 42 U.S.C.). As enacted, ERISA comprises four titles: Title I (codified in 29 U.S.C. §§ 1001-1144) contains the sections establishing employee benefit rights administered by the Secretary of Labor; Title II (codified in scattered sections of 26 U.S.C.) contains amendments to the Internal Revenue Code; Title III concerns jurisdiction, administration and enforcement; and Title IV creates an insurance system for plan terminations. Titles I and II contain virtually identical language regarding plan participation, vesting, and funding. Though different consequences do flow from violations of the two sets of provisions, *e.g.*, ERISA § 502, 29 U.S.C. § 1132 (Supp. V 1975), grants a private civil cause of action, the primary reason for the extensive overlap in Titles I and II probably stems from the jurisdictional disputes between the tax and labor committees of both the House and Senate. *See Lee, The "Elaborate Interweaving of Jurisdiction": Labor and Tax Administration and Enforcement of ERISA and Beyond*, 10 RICH. L. REV. 463, 466 (1976) [hereinafter cited as Lee].

2. The term "retirement plan" will be used herein interchangeably with "employee pension benefit plan," *see* ERISA § 3 (2), 29 U.S.C. § 1002 (2) (Supp. V 1975), to refer to both pension plans that provide retirement income, and profit sharing plans that usually provide a deferral of income. The chief characteristic of a defined benefit pension plan is that the promise made by the employer concerns the ultimate retirement benefits to be paid the employees who participate in the plan. *See* ERISA, § 3 (35), 29 U.S.C. § 1002 (35) (Supp. V 1975); I.R.C. § 414 (j). Under a defined contribution profit sharing plan, on the other hand, the most constant variable in the pension promise concerns the amount of contributions to be made to the plan by the employer. *See* ERISA, § 3 (34), 29 U.S.C. § 1002 (34) (Supp. V. 1975); I.R.C. § 414 (i). In the former the employer bears the risk of investment loss, while in the latter the investment risk is borne by the participants.

3. The term "participant" is defined 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.

ERISA, § 3 (7), 29 U.S.C. § 1002 (7) (Supp. V 1975).

The term "cause" refers to activities such as excessive absenteeism, insubordination or fighting on the job, which commonly provide the basis for a discharge.

4. *See generally* text accompanying notes 146 through 178 *infra*.

fied certain restrictions on the operation of bad boy clauses,⁵ the Service did not prohibit them entirely. Furthermore, anticompetitive forfeiture provisions were not prohibited by either the Internal Revenue Code,⁶ the Welfare and Pension Plan Disclosure Act of 1958,⁷ or the federal antitrust laws.⁸ In the absence of federal regulation before ERISA, state law alone determined the enforceability of bad boy clauses. On the eve of ERISA, the majority of states upheld such clauses.⁹

Under section 514 of ERISA,¹⁰ the provisions of Title I of ERISA

5. I.R.C. § 401 establishes the general requirements that a plan must meet to achieve "qualified" status. Plan qualification results in the following: (1) deferral of taxation for the participant, *see* 26 U.S.C. § 402 (1970 & Supp. V 1975); (2) current deductions for the contributing employer though taxation to the participant is deferred, *see* 26 U.S.C. § 404 (1970 & Supp. V 1975); and (3) exemption from taxation for the trust forming part of the plan, *see* I.R.C. § 501 (a).

Pre-ERISA pronouncements from the Service acknowledged that a qualified plan might limit or entirely discontinue benefits to an employee discharged for cause. *See* IRS, U.S. Treasury Dep't, Publication No. 778, *Guides for Qualification: Pension, Profit-Sharing, and Stock Bonus Plans*, pt. 5 (c) (3) (1972). The Service did require that such bad boy clauses could not discriminate in favor of the prohibited group as defined in I.R.C. § 401 (a) (4) (contributions or benefits provided under the plan cannot discriminate in favor of employees who are officers, shareholders or highly compensated). While the plan would have to distinctly specify the causes that would result in benefit forfeiture, terms such as misconduct and dishonesty did not have to be defined. *See* Rev. Rul. 71-92, 1971-1 C. B. 122.

6. *Nolan v. Meyer*, 520 F.2d 1276, 1279 (2d Cir.), *cert. denied*, 423 U.S. 1034 (1975).

7. *Lieberman v. Cook*, 343 F. Supp. 558 (W.D. Pa. 1972) (construing Pub. L. No. 85-836, 76 Stat. 38 (1948) (codified in 29 U.S.C. § 301-3-9 (1970) which was repealed by ERISA).

8. *Golden v. Kentile Floors, Inc.*, 512 F.2d 838 (5th Cir. 1975); *Austin v. House of Vision*, 404 F.2d 401 (7th Cir. 1969); *Graham v. Hudgins, Thompson, Ball & Assoc., Inc.*, 319 F. Supp. 1335 (N.D. Okla. 1970).

9. *Rochester Corp. v. Rochester*, 450 F.2d 118, 122-23 (4th Cir. 1971). *See generally* Annot., 18 A.L.R.3d 1246 (1968).

10. Section 514 of ERISA provides:

(a) Except as provided in subsection (b) of this section, the provisions of this title and title IV shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan described in section 4 (a) and not exempt under section 4 (b). This section shall take effect on January 1, 1975.

(b) (1) This section shall not apply with respect to any cause of action which arose, or any act or omission which occurred, before January 1, 1975.

(2) (A) Except as provided in subparagraph (B), nothing in this title shall be construed to exempt or relieve any person from any law of any State which regulates insurance, banking, or securities.

(B) Neither an employee benefit plan described in section 4 (a), which is not exempt under section 4 (b) (other than a plan established primarily for the purpose of providing death benefits), nor any trust established under such a plan, shall be deemed to be an insurance company or other insurer, bank, trust company, or investment company or to be engaged in the business of insurance or banking for purposes of any law of any State purporting to regulate insurance companies, insurance contracts, banks, trust companies, or investment companies.

(3) Nothing in this section shall be construed to prohibit use by the Secretary of services or facilities of a State agency as permitted under section 506 of this Act.

(4) Subsection (a) shall not apply to any generally applicable criminal law of a state.

generally supersede all state laws relating to employee benefit plans, effective January 1, 1975. However, the ERISA minimum vesting standards are not effective for a plan in existence on January 1, 1974, until its first plan year¹¹ beginning after December 31, 1975.¹² Because of this potential twenty-three month delay between ERISA preemption of state law,¹³ and the effective date of the minimum vesting standards the validity of bad boy provisions during this interim period is unclear.

A second question concerns the continued effect of bad boy clauses on otherwise "vested" plan rights that exceed the requirements of ERISA's minimum vesting standards, after those standards become effective.¹⁴ The basic thrust of ERISA mandates compliance with minimum vesting standards for employee pension benefit plans. Under these requirements, a participant's accrued benefit¹⁵ derived from employer contributions becomes "nonforfeitable" upon the occurrence of certain events. Usually, the controlling event will be the completion of a specified number of years of service¹⁶ with

(c) For purposes of this section:

(1) The term "State law" includes all laws, decisions, rules, regulations, or other State action having the effect of law, of any State. A law of the United States applicable only to the District of Columbia shall be treated as a State law rather than a law of the United States.

(2) The term "State" includes a State, any political subdivisions thereof, or any agency or instrumentality of either, which purports to regulate, directly or indirectly, the terms and conditions of employee benefit plans covered by this title.

(d) Nothing in this title shall be construed to alter, amend, modify, invalidate, impair, or supersede any law of the United States (except as provided in sections 111 and 507 (b)) or any rule or regulation issued under any such law.

29 U.S.C. § 1144 (Supp. V 1975).

11. The terms "plan year" and "fiscal year of the plan" are defined as the "calendar, policy or fiscal year on which the records of the plan are kept." ERISA, § 3 (39), 29 U.S.C. § 1002 (39) (Supp. V 1975).

12. ERISA, § 211 (b), 29 U.S.C. § 1061 (b) (Supp. V 1975); ERISA § 1017, I.R.C. § 410 (historical note).

13. In the case of a plan year ending November 30, 1976, the first plan year to which the minimum vesting standards applied was the fiscal year beginning December 1, 1976, 23 months after January 1, 1975.

14. See Temp. Treas. Reg. § 11.411 (a)- 4 (c) (example 1), 40 Fed. Reg. 51,424 (November 5, 1975).

15. "Accrued benefit" is defined in Title I of ERISA as:

(A) in the case of a defined benefit plan, the individual's accrued benefit determined under the plan and . . . expressed in the form of an annual retirement benefit commencing at normal retirement age, or

(B) in the case of a plan which is an individual account plan [e.g., profit-sharing plans] the balance of the individual's account.

ERISA, § 3 (23), 29 U.S.C. § 1002 (23) (Supp. V 1975).

16. For purposes of determining a participant's vesting rights, Titles I and II of ERISA define a "year of service" as: "a calendar year, plan year, or other 12-consecutive-month

the employer who maintains the plan.¹⁷ Under pre-ERISA tax law, the term "nonforfeitable" meant, among other things, that a vested interest would not be forfeited if an employee violated a bad boy clause.¹⁸ This result apparently also occurs under the ERISA minimum vesting standards, *i.e.*, violation of a bad boy clause will not legally cause a forfeiture of a former participant's "nonforfeitable" accrued benefits. The congressional committee reports on ERISA repeatedly state, for example, that "a vested benefit is not to be forfeited because the employee later went to work for a competitor, or in some other way was considered 'disloyal' to the employer."¹⁹ However, in this context, "vested" apparently refers to only that portion of the plan rights that ERISA minimum standards require to be nonforfeitable.²⁰ Thus, it remains an open question whether a bad boy clause could be enforced to effect a forfeiture of plan benefits that exceed the ERISA minimum vested amount.

During the floor debate, the comments of Representative Dent,

period designated by the plan (and not prohibited under regulations prescribed by the Secretary [of Labor]) during which the participant has completed 1,000 hours of service." ERISA, § 203 (b)(2) (A), 29 U.S.C. § 1053 (b)(2) (A) (Supp. V 1975); I.R.C. § 411 (5) (A). Special provisions are made for seasonal and maritime industries and regulations are to be promulgated by the Secretary of Labor defining the term "hour of service." Years of service are required to be distinguished from "years of participation" which are defined in § 411 (b) (3) (A) of the Internal Revenue Code:

[f]or purposes of determining an employee's accrued benefit, . . . [as] a period of service (beginning at the earliest date on which the employee is a participant in the plan and which is included in a period of service to be taken into account under section 410 (a) (5) [minimum participation standards]) as determined under regulations prescribed by the Secretary of Labor which provide for the calculation of such period on any reasonable and consistent basis.

I.R.C. § 411 (b)(3)(A).

17. ERISA, § 203 (a) (2), 29 U.S.C. § 1053 (a) (2) (Supp. V 1975); ERISA, § 1012 (a) (2), I.R.C. § 411 (a) (2). Sections 203 (a) (2) and 1012 (a) (2) establish three alternative minimum vesting standards: (1) 10 year "cliff" vesting; (2) 5 to 15 year "graduated" vesting; and (3) "rule of 45" vesting. For a discussion of these alternatives see text accompanying notes 80-96 *infra*. The number of a participant's years of service are figured into his retirement plan's vesting schedule to obtain a percentage value. This value is then applied to the monetary figure which represents the participant's accrued benefits to obtain the monetary value of his nonforfeitable accrued benefits.

18. See *Liberty Mach. Works, Inc.*, 62 T.C. 621 (1974), *aff'd*, 518 F.2d 554 (8th Cir. 1975); *Hazel v. Pollnow*, 35 T.C. 715 (1961). Title I seems to define the term "nonforfeitable" to similar effect: "a claim obtained by a participant or his beneficiary to that part of an immediate or deferred benefit under a pension plan which arises from the participant's service, which is unconditional, and which is legally enforceable against the plan." ERISA, § 3 (19), 29 U.S.C. § 1002 (19) (Supp. V 1975).

19. S. REP. No. 93-383, 93d Cong., 1st Sess. 50 (1973) [hereinafter cited as S. REP. No. 93-383]; accord, H.R. REP. No. 93-807, 93d Cong., 2d Sess. 60 (1974) [hereinafter cited as H.R. REP. No. 93-807].

20. The language quoted in the text is merely a more narrow application of the statement that "no rights, once they are required to be vested, may be lost by the employee under any circumstances. . . ." S. REP. No. 93-383, note 19 *supra*, at 50.

Chairman of the General Subcommittee on Labor of the House Committee on Education and Labor, and a prime supporter of ERISA, indicate that such excess benefit forfeitures could be a possibility. "Another issue dealt with in the conference report is the policy against what has been described as 'bad boy' clauses. While firmly articulating this policy, the conferees expressly provided . . . that a plan be permitted to suspend benefits under certain circumstances."²¹

This article will address the issues raised by the interplay of ERISA provisions and bad boy clauses: (1) whether state or federal common law governs the enforceability of bad boy clauses during the interim period between section 514 preemption of state law and the effective date of the minimum vesting standards; and (2) whether excess benefits can be forfeited, both during and after the interim period, by operation of a bad boy clause.

Resolution of these questions requires an examination of the legislative history of ERISA, its relevant provisions, and prior state law concerning forfeiture of accrued benefits. Two recent conflicting decisions²² that directly address the "gap" issue will be considered first, in order to present clearly the issues and to suggest answers to the second question of excess benefit forfeitures.

POSITING THE ISSUE: *Amory* AND *Keller*

In *Amory v. Boyden Associates, Inc.*,²³ the plaintiff was employed by Boyden Associates, Inc., the plan sponsor,²⁴ for sixteen years. In July, 1975, Amory voluntarily resigned in order to work for another firm. At that time the vested portion of the benefits allocated to his account under Boyden's profit-sharing plan amounted to approximately \$70,000. However, the plan contained a provision by which a participant's vested benefits would be forfeited if he went to work for a competitor within five years of termination with the plan sponsor. In August, 1975, the plan's managing committee²⁵ determined

21. 120 CONG. REC. 29197 (1974), reprinted in III STAFF ON SUBCOMM. ON LABOR OF THE SENATE COMM. ON LABOR AND PUBLIC WELFARE, 94 Cong., 2d Sess., LEGISLATIVE HISTORY OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974, at 4669 (Comm. Print 1976) [hereinafter cited as LEGISLATIVE HISTORY].

22. *Amory v. Boyden Associates, Inc.*, 434 F. Supp. 671 (S.D.N.Y. 1976). *Keller v. Graphic Systems, Inc.*, 422 F. Supp. 1005 (N.D. Ohio 1976).

23. 434 F. Supp. 671 (S.D.N.Y. 1976).

24. A "plan sponsor" is the employer in the case of a plan maintained by a single employer. ERISA, §3(16) (B) (i), 29 U.S.C. § 1002 (16) (B) (i) (Supp. V 1975). If the plan does not otherwise provide, the plan sponsor is also the "administrator" of the plan. *Id.* § 3 (16) (A) (ii).

25. Many pre-ERISA pension plans allocated administrative functions to a committee,

that Amory was employed by a competitor and accordingly suspended his benefits.

In *Keller v. Graphic Systems, Inc.*,²⁶ the plaintiff also voluntarily terminated his twelve years of employment and immediately went to work for a competitor. Keller's termination of employment occurred in August, 1973, prior to any of ERISA's effective dates.²⁷ However, the employer's qualified profit-sharing plan required a terminated employee to wait for a period of two years before vested benefits could be distributed. The plan also established a complete forfeiture of vested rights if, after termination, a participant entered into employment with a direct competitor of the plan sponsor. Keller had four full years of participation in the plan²⁸ at the time of his termination, and a forty percent vested interest in his account balance of \$11,738. In July, 1974, Keller was informed that the trustees intended to declare a forfeiture of his vested interest due to his violation of the plan's noncompetition clause. Thereafter, upon the expiration of the two year waiting period in August, 1975, Keller's counsel made a demand upon the plan trustees for payment of his vested interest.²⁹ The trustees denied Keller's claim.

Thus, in *Keller* and *Amory*, the federal district courts³⁰ considered the law applicable to "bad boy" clauses during the gap period between the effective date of the ERISA preemption provisions and the ERISA minimum vesting provisions and reached different results.

commonly designated a retirement or administrative committee. This was particularly true when the plan had a corporate trustee.

26. 422 F. Supp. 1005 (N.D. Ohio 1976).

27. The earliest ERISA effective date is June 30, 1974, ERISA, § 4082 (b) (2), 29 U.S.C. § 1381 (b) (2) (Supp. V 1975) (the "open window" for certain plan terminations with regard to ERISA termination insurance provisions). For a novel attempt to obtain ERISA jurisdiction on the ground that a cause of action arose at the time of a pre-ERISA termination but lay dormant until September 2, 1974, the date of ERISA's enactment, see *Martin v. Bankers Trust Co.*, 417 F. Supp. 923 (W.D. Va. 1976).

28. Under ERISA the nonforfeiture of accrued benefits under all pension plans (except "class year" plans and plans with immediate vesting) depends in part upon completion of "years of service," see notes 11 and 15 *supra*, including, with certain exceptions, years of service completed prior to entry into the plan. The exceptions include years of service during which the plan sponsor did not maintain the plan. ERISA, § 203 (b)(1) (c), 29 U.S.C. § 1053 (b) (1) (c) (Supp. V 1975); I.R.C. § 411 (a) (4) (C). However, under pre-ERISA plan design, vesting frequently depended solely upon years of participation in the plan.

29. Both parties agreed that Keller's cause of action arose on August 31, 1975, when demand for payment was made following expiration of the two year waiting period. 422 F. Supp. at 1007.

30. United States district courts and state courts of competent jurisdiction have concurrent jurisdiction over actions to recover benefits due under a plan arising after December 31, 1975. ERISA, §§ 502 (a) (1) (B), (e) (1), 514 (b) (1), 29 U.S.C. §§ 1132 (a) (1) (B), (e) (1), 1144 (b) (1) (Supp. V 1975).

In *Keller*, the district court ruled that since the minimum vesting requirements of ERISA were not yet effective, it "must look to pre-ERISA federal and state law with regard to private profit sharing and retirement plans. . . ." ³¹ Because Keller's claim to a vested interest arose independently of ERISA, *a fortiori* it arose under state law. Accordingly, the district court concluded that under *Erie Railroad Co. v. Tompkins*³² state law governed Keller's claim and held that an Ohio state court would apply a "reasonableness" test and uphold the forfeiture.³³ However, the *Keller* court failed to consider the effect of the ERISA preemption provision.³⁴

In contrast, in *Amory* the District Court for the Southern District of New York squarely faced the gap issue. That court noted the absence of an express provision in ERISA dealing with bad boy forfeitures of vested rights declared during the interim period. According to the *Amory* court, these forfeitures are outlawed only as of the effective date of the minimum vesting standards. The court acknowledged that "plaintiff would have us fill this apparent void [the gap period] by pre-dating the prohibition of forfeitures, while defendants would have us rule that insofar as it concerns forfeitures, [ERISA] is wholly without effect until January of 1976."³⁵ The court rejected both approaches, instead ruling that during the gap period the effect and operation of bad boy clauses must be governed by federal common law derived from ERISA.³⁶ Thus, the *Amory* rule is that during the interim:

declarations of forfeiture of vested pension rights must be subject to judicial scrutiny according to a reasonableness test. The standard of reasonableness, should, as a consequence of the public policy expressed in the Congressional mandate, be a rigorous one and should be applied both to forfeiture provisions and their application. . . . Indeed, we believe that during this interim period ERISA creates a presumption of unreasonableness in forfeiture

31. *Keller v. Graphic Systems, Inc.*, 422 F. Supp. 1005, 1009 (N.D. Ohio 1976).

32. 304 U.S. 64 (1938). See notes 129 through 136 and accompanying text *infra*.

33. Because no Ohio state court had actually ruled on the enforceability of a bad boy clause in a qualified plan, the United States District Court for the Northern District of Ohio was forced to decide the issue as if it were an Ohio state court. In doing so the court adopted the "majority" state rule, which upholds the "validity of noncompetition forfeiture provisions in pension plans absent a statute to the contrary. . . ." 422 F. Supp. at 1013.

34. While the court cited ERISA, § 514, 29 U.S.C. § 1144 (a) (Supp. V 1975), it focused primarily on the effective date of the minimum vesting standards, ERISA, § 211, 29 U.S.C. § 1061 (Supp. V 1975). While properly noting that the ERISA vesting standards were not yet effective, the court concluded that since ERISA was not dispositive of the vesting and forfeiture issue, state law applied. 422 F. Supp. at 1008-09.

35. *Amory v. Boyden Associates, Inc.*, 434 F. Supp. 671, 672 (S.D.N.Y. 1976).

36. *Id.*

provisions and places the burden of proof on those who wish to apply them.³⁷

According to the *Amory* court, this conclusion is strengthened by the fact that the effective date of ERISA's ban on forfeiture provisions in pension plans was delayed until January 1, 1976,³⁸ "not because of any Congressional hesitancy concerning the wisdom of the prohibition, but because employers needed more time to insure that their funds were adequately financed to comply with the statute's vesting requirements of which the anti-forfeiture section is a part."³⁹

In contrast, the *Keller* opinion rejected the argument that the forfeiture was contrary to an emerging public policy opposing forfeitures of vested rights. While ERISA emphasizes nonforfeitable pension benefits and replaces the prior considerations of reasonableness and business justification, "[i]t required comprehensive legislation . . . to make that new consideration preeminent and such legislation is prospective in operation . . . To invalidate past action on the basis of present and future policy would be manifestly unfair."⁴⁰

Interestingly, in the course of deciding the validity of bad boy forfeitures during the gap period, both the *Amory* and *Keller* courts assumed that after the effective date of the minimum vesting provisions, a plan participant's vested rights to qualified plan benefits could not be forfeited by operation of a bad boy clause prohibiting competitive behavior.

However, neither court considered temporary Treasury regulations, recently finalized, which were already almost a year old at the time of the opinions.⁴¹ These regulations permit bad boy forfeitures of rights vested in excess of the ERISA nonforfeitable minimum.⁴² In addition, the pre-ERISA vesting schedule in *Keller* easily could be brought within the parameters of a regulation example that per-

37. *Id.* at 673.

38. *Id.* More accurately, § 203 of ERISA does not become effective for plans in existence on January 1, 1974, until the first plan year beginning after December 31, 1975. ERISA, § 211 (b) (2), 29 U.S.C. § 1061 (b) (2) (Supp. V 1975); I.R.C. § 410 (historical note).

39. *Amory v. Boyden Associates, Inc.*, 434 F. Supp. 671, 673 (S.D.N.Y. 1976).

40. *Keller v. Graphic Systems, Inc.*, 422 F. Supp. 1005, 1014 (N.D. Ohio 1976).

41. See text accompanying notes 101 through 103 *infra*. Those regulations have been promulgated in final form and may be found at 42 Fed. Reg. 42,318 (Aug. 23, 1977).

42. Temp. Treas. Reg. § 1.411 (a) - 4 (a), 40 Fed. Reg. 51,423 (Nov. 5, 1975) ("To the extent that rights are not required to be nonforfeitable to satisfy the minimum vesting standards, or the nondiscrimination requirements of § 401 (a) (4), they may be forfeited. . . ."). The final regulations promulgated in 42 Fed. Reg. 42,326 (Aug. 23, 1977) contain identical language.

mits a forfeiture for cause.⁴³ Thus, under the Treasury Department's reasoning the ERISA minimum vesting requirements apparently permit a forfeiture on facts such as those in *Keller*.⁴⁴ The *Amory* court correctly held that during the interim period between the effective date of the ERISA preemption provision and the effective date of the minimum vesting standards, federal common law derived from ERISA and its underlying public policy should govern bad boy clauses. However, that court erred by interpreting federal common law to require a reasonableness test of these clauses. An examination of the legislative history of ERISA's preemption and vesting provisions, and the public policy underlying them will show that federal common law should declare unenforceable all bad boy clauses during the gap period as well as after the effective date of the minimum vesting standards. Furthermore, the same public policy supports a voiding of bad boy forfeitures as to benefits vested in excess of the minimum standards.

ERISA'S NONFORFEITABILITY PROVISIONS

Background and History

Before ERISA, over two-thirds of the privately maintained qualified retirement plans provided vested rights to benefits prior to retirement. But, generally, under the larger plans employees did not acquire vested rights until they either were relatively mature or had

43. *Id.* §§ 11.411 (a)-4 (c) (example 1), 40 Fed. Reg. 51,423-24. Treas. Reg. § 1.411 (a)-4 (c) (example 1), 42 Fed. Reg. 42,327 (Aug. 23, 1977). See notes 101 through 102 and accompanying text *infra*.

44. Under ERISA, a plan's vesting schedule is permitted to disregard years of service completed prior to the establishment of the plan. ERISA, § 203 (b) (1) (c), 29 U.S.C. § 1053 (b) (1) (c) (Supp. V 1975); I.R.C. § 411 (a) (4) (c). Therefore, the *Keller* plan's vesting schedule could be amended to provide 10% vesting for each year of service (disregarding years of service completed prior to March 1, 1969, the plan's original effective date), subject to divestiture for cause until completion of 10 years of such service. The plan would then meet the 10 year "notch" minimum nonforfeitability alternative of § 411 (a) (2) (A) of the Internal Revenue Code, and § 11.411 (a)-4 (c) (example 1) of the temporary and final Treasury regulations. Also, under Revenue Procedure 76-11, 1976-1 C.B. 550, a plan is deemed to meet the requirement of § 401 (a) (4) of the Internal Revenue Code, if its vesting schedule meets one of the ERISA minimum vesting, *i.e.*, nonforfeitability, requirements and, "in the case of any plan which had previously been the subject of a favorable advance determination letter which has not been revoked, [if] the percentage of vesting of each participant provided under the plan, as amended, is not less (at every point) than that provided under the vesting schedule of the plan upon which such most recent prior determination letter was based. . . ." *Id.* § 3.01 (2). Under its then most recent determination letter, the *Keller* plan provided 10% vesting for each year of participation, subject to divestiture for cause. Thus, the *Keller* plan would have met the test in Revenue Procedure 76-11 quoted above if it had been amended to include a vesting schedule which recognized 10% for each year of service (disregarding years of service completed prior to the plan's original effective date), subject to divestiture for cause prior to completion of 10 years of service. See *Lee, Credited Service After ERISA*, 31 *Tax. L. Rev.* 365, 465 (1976) [hereinafter cited as *Credited Service*].

completed a long period of participation.⁴⁵ Specifically, only one-third of the private plan participants had a fifty percent vested right to accrued retirement benefits. Moreover, fifty-eight percent of the plan participants between the ages of fifty and sixty, and fifty-four percent of those age sixty and over were not even fifty percent vested.⁴⁶ Consequently, even employees with substantial periods of service could lose their retirement benefits upon separation from service. In extreme cases, aged participants lost their entire retirement benefits due to their discharge shortly before reaching retirement age.⁴⁷

Representative Dent believed that vesting constituted the worst situation encountered in the congressional examination of the entire private pension system.⁴⁸ Senator Long, Chairman of the Senate Committee on Finance, also pointed out:

Now, what kind of equity is there in a situation where you have a company, which because of normal turnover of personnel, has an employee who stayed with the company for 30 years and then left, and the company picks up the pension that he left. Not only that pension but the pension that perhaps 50 other people *earned*. What kind of justice is that?⁴⁹

Long's and Dent's premise, accepted by commentators,⁵⁰ was that employer contributions constitute deferred wages earned by the par-

45. S. REP. NO. 93-383, *supra* note 19, at 14; H.R. REP. NO. 93-807, *supra* note 19, at 12.

46. *Id.*

47. Plan rules governing service-related eligibility requirements, such as a requirement that 20 years of service be completed, uninterrupted by a "break-in-service" (a 12 month period during which a participant is credited with less than 500 hours of service, *see, e.g.*, ERISA, § 2-3 (b)(3)(A), 29 U.S.C. § 1053 (b)(3)(A) (Supp. V 1975)) have generated considerable litigation. *See, e.g.*, Johnson v. Botica, 537 F.2d 930 (7th Cir. 1976); Foley v. Devaney, 528 F.2d 888 (3d Cir. 1976); Lugo v. Employees Retirement Fund of Illum. Prods. Indus., 529 F.2d 251 (2d Cir. 1976); Maness v. Williams, 513 F.2d 1264 (8th Cir. 1975); Giler v. Board of Trustees of Sheet Metal Workers Pension Plan, 509 F.2d 848 (9th Cir. 1975); Pete v. U.M.W. Welfare and Retirement Fund, 517 F.2d 1267 (D.C. Cir. 1975).

48. *Hearings on H.R. 2 and H.R. 462 before the General Subcomm. on Labor of the House Comm. on Education and Labor*, 93d Cong., 1st Sess. 499 (1973) [hereinafter cited as *H.R. 2 Hearings*] ("The real problem is the vesting where men have worked for 40 and more years for different employers and they never vested anywhere.").

49. *Hearings on S. 4, S. 1179, and S. 1631 Before the Subcomm. on Private Pension Plans of the Senate Comm. on Finance*, 93d Cong., 1st Sess. 1, 340 (1973) [hereinafter cited as *Senate Finance Hearings*]; *see* 120 CONG. REC. 4287 (1974), *reprinted in* II LEGISLATIVE HISTORY, *supra* note 21, at 3395 ("It is immoral to require a worker to forfeit 25 years of pension contributions and benefits if he exercises his God-given right to take another job . . .") (statement of Rep. Biaggi).

50. Note, *Pension Plans and the Rights of the Retired Worker*, 70 COLUM. L. REV. 909, 917 (1970) [hereinafter cited as *Rights of the Retired Worker*]; Note, *Forfeiture of Pension Benefits for Violation of Covenants Not to Compete*, 61 NW. L. REV. 290, 292-94 (1966) [hereinafter cited as *Forfeiture of Benefits*]. *See, e.g.*, Boyer v. Piper, Jaffray & Hopwood,

ticipants and not merely employer gratuities. The ERISA committee reports indicate that both houses of Congress agreed forfeitures of pension benefits upon separation from service were inequitable, apart from the resulting hardships, "since the pension contributions previously made on behalf of the employee may have been in lieu of additional compensation or some other benefit which he would have received."⁵¹ Furthermore, factors such as the mobile nature of the American economy wherein employees tend to change jobs frequently, and the cyclical nature of certain industries plagued by frequent layoffs added to the tax committees' belief in the necessity for vesting standards that insure covered employees will actually benefit from retirement plans.⁵² Insofar as Congress thought that more rapid vesting would improve the mobility of labor and thereby promote a more healthy economy,⁵³ eliminations of bad boy clauses would be consonant with that goal.

Representative Dent believed that ideally an employee should be fully vested after only a trial period of service.⁵⁴ But Congress was

aware that under our voluntary pension system, the cost of financing pension plans is an important factor in determining whether any particular retirement plan will be adopted, and that unduly large increases in costs could impede the growth and improvement of the private retirement system. For this reason, in the case of those requirements which add to the cost of financing retirement plans, the committee has sought to adopt provisions which strike a balance between providing meaningful reform and keeping costs within reasonable limits.⁵⁵

In other words, Congress recognized that a requirement of immediate and full vesting was not feasible since additional costs would inhibit employer willingness to adopt new plans and to liberalize existing plans.⁵⁶ Ultimately, the House committees, faced with the

Inc., 391 F. Supp. 471, 473 (D.S.Dak. 1975); *Ware v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 24 Cal. App. 3d 35, 100 Cal. Rptr. 791, 797-98 (1972); *Van Hosen v. Bankers Trust Co.*, 200 N.W.2d 504 (Iowa 1972).

51. S. REP. NO. 93-383, *supra* note 19, at 45; H.R. REP. NO. 93-807, *supra* note 19, at 53.

52. H.R. REP. NO. 93-807, *supra* note 19, at 18; S. REP. NO. 93-383, *supra* note 19, at 19.

53. S. REP. NO. 93-383, *supra* note 19, at 45. For a thoughtful analysis of the effects of vesting on employee mobility see Norman, *Private Pensions: A Study of Vesting, Funding, and Integration*, 21 FLA. L. REV. 141, 156-59 (1968) [hereinafter cited as Norman]; see also Koehn & Ptacek, *Employer Protection Against Loss of the Key Employee*, 57 IOWA L. REV. 75 (1971) [hereinafter cited as Koehn & Ptacek].

54. H.R. 2 *Hearings*, *supra* note 48, at 285, 499; see also S. REP. NO. 93-383, *supra* note 19, at 19; H.R. REP. NO. 93-807, *supra* note 19, at 19.

55. S. REP. NO. 93-383, *supra* note 19, at 18.

56. *Id.* at 15-19; H.R. REP. NO. 93-807, *supra* note 19, at 19; H.R. 2 *Hearings*, *supra* note 48, at 235, 330, 411, 509; *Senate Finance Hearings*, *supra* note 49, at 346-51, 354.

necessity of providing adequate flexibility for minimum vesting standards for thousands of retirement plans, concluded that it was not desirable to force all retirement plans into one rigid vesting schedule.⁵⁷

The Nixon administration, at the ERISA hearings, articulated other, perhaps ideological considerations such as the role of government intervention in pension planning. The administration advocated the view that unions and employers in collective bargaining already had negotiated trade-offs between vesting rights and benefit levels.⁵⁸ A related criticism was voiced by Representative Erlenborn, the ranking minority member of the General Subcommittee on Labor of the House Committee on Education and Labor. He felt that organized labor had negotiated for and received high benefit levels, primarily because of the large numbers of forfeitures resulting from the permissible slow vesting. Having achieved high levels of benefits, labor now was unfairly "coming to Congress to impose on plans additional costs for vesting that . . . [labor] had not negotiated for."⁵⁹

57. H.R. REP. NO. 93-807, *supra* note 19, at 19; 120 CONG. REC. 4287, 4292 (1974) (remarks of Reps. Biaggi and Ullman, respectively), *reprinted in* II LEGISLATIVE HISTORY, *supra* note 21, at 3395, 3407.

58. As then Secretary of Treasury Shultz stated during the 1973 hearings before the Senate Committee on Finance:

People have to make a judgment about the nature of the plan they want to agree to. I think to a degree we have to say in the government that if the unions and management want to make an agreement of some kind and it is satisfactory to them and it is full and open and above board, then we should think twice about putting ourselves above their judgment in this tradeoff that they have.

Now, in imposing a rule of vesting of some kind—and I have no doubt this is the reason why Congress has not done it up to this point—you are imposing a governmental judgment on these private plans. And we think that it is appropriate to do that but not to go so far as to basically destroy the cost basis of the gigantic private pension plans we have.

Senate Finance Hearings, supra note 49, at 341; *see also H.R. 2 Hearings, supra* note 48, at 72-73, 388-89 (remarks of Reps. Burton and Erlenborn, respectively).

59. *H.R. 2 Hearings, supra* note 48, at 421. The same type of thought process is reflected in a recent Eighth Circuit case which held that federal labor law preempted the Minnesota Pension Act, MINN. STAT. §§ 181 B.01-17 (1976). *White Motor Corp. v. Malone*, 545 F.2d 599 (8th Cir. 1976). The state statute required the employer to fund fully his plan's past service liability, *i.e.*, liability attributable to service completed prior to the plan's establishment, upon termination of the plan or cessation of operations at a place of employment. MINN. STAT. § 181 B.03 (1976). Prior to the enactment of ERISA, past service liability was amortized over a 40 year period, if credit was given at all for service prior to the plan's establishment. Thus, the statute was preempted, since it directly intruded upon the employer's substantive obligations under a plan which resulted from negotiations conducted pursuant to the National Labor Relations Act, as follows:

(1) the [state] Act grants employees vested rights to pension benefits which are not available under the pension plan; (2) to the extent of any deficiency in the pension fund, the [state] Act requires satisfaction of pension benefits from the

The administration's negotiation analysis was, in turn, criticized by Ralph Nader who alleged that the union negotiators had failed to adequately represent employee participants due to conflicts of interest.⁶⁰ The conflicts of interest were not, however, between union officials and the employees they represented. In many cases, particularly in the low-wage industries, the primary conflict centered on the relative priority to be accorded the competing interests of young workers with up to thirty-five years remaining until retirement, and old workers nearing retirement age.⁶¹ In effect, the thrust of the pension reform movement concerning vesting schedules favored congressionally enacted minimum standards which organized labor perhaps, simply could not achieve through collective bargaining. Yet, Congress was well aware of the thin line distinguishing viable minimum standards from those which would impose costs resulting

general assets of the employer, while the pension plan provides that benefits shall be paid only out of the pension fund; and (3) the [state] Act does not permit employers to escape liability for funding of pension rights, but the pension plan permits White Motor to terminate the plan at any time, and in so doing end any liability for future payments to the pension fund, save those specifically guaranteed.

545 F.2d at 603. *Contra*, *Raybestos-Manhattan, Inc. v. Glazer*, 144 N.J. Super. 152, 365 A.2d 1, 23 (Sup. Ct. Ch. 1976) (upholding a New Jersey statute similar to the Minnesota statute stricken by the Eighth Circuit in *White Motor Corp. v. Malone*, 545 F.2d 599 (8th Cir. 1976), based upon the reasoning of the subsequently reversed district court opinion in *Malone*, 412 F. Supp. 372 (D. Minn. 1976)).

60. Ralph Nader, as well as other commentators, maintained that the traditional "bargaining through representatives" approach broke down in the area of retirement benefits due to certain conflicts of interest: (1) union officials, because of their long service, are among the chief beneficiaries of the present pension planning system; and (2) bargaining for slight, but illusory, benefits wins more re-elections for unions and union leaders than securing the ability to threaten dissident bargaining unit employees with the argument that a change in bargaining representatives might result in the loss to employees of their pensions. *H.R. 2 Hearings*, *supra* note 48, at 35, 251, 421-22. Representative Dent took a more balanced view:

Up to now we have had some adherence to the so-called enterprise system and the unions' right to negotiate. Some of us think it is still a pretty good thing to do. However, when we find situations are getting out of hand, we move in, but we don't want the reform to kill what we are trying to reform.

H.R. 2 Hearings, *supra* note 48, at 283. Similarly, Senator Long thought that if collective bargaining under ERISA resulted, for example, in the receipt of benefits by only 50% of the employees who worked for an employer who maintained a plan, "we have written a very poor law. We have fixed it up so that the business agent took care of the business agent, so that . . . [the employer] took care of . . . [the employer], but half of those working people suffered very badly." *Senate Finance Hearing*, *supra* note 49, at 341.

61. See *H.R. 2 Hearings*, *supra* note 48, at 328, 336-37 (remarks of Jacob Sheinkman, General Secretary-Treasurer, Amalgamated Clothing Workers). It should be noted that such tensions, however, are basically inconsistent with the position that retirement benefits constitute a deferred payment of wages earned by the participant. See Halperin, *Retirement Security and Tax Equity: An Evaluation of ERISA*, 17 B.C. IND. & COM. L. REV. 739, 746, 748 (1976); notes 50 and 51 and accompanying text *supra*.

in either reduced benefits or plan terminations.⁶² Thus, two competing interests had to be balanced: the desire to encourage creation of private plans that would provide retirement benefits for the fifty percent of the labor force⁶³ without such coverage against the desire to establish meaningful vesting standards.

Closely allied to the question of cost was the issue whether to require retroactive vesting for service completed and benefits accrued prior to enactment of ERISA. The Nixon administration noted the cost of such retroactivity would be very high—an assumption disputed by some legislators.⁶⁴ Furthermore, former Secretary of the Treasury Shultz contended that retroactive vesting would “second-guess all of the decisions” between union and management as to what purchases ought to be made with the pension dollar—greater benefits versus faster vesting.⁶⁵ Accordingly, witnesses at the congressional hearings on ERISA suggested various compromises regarding retroactivity.⁶⁶ Witnesses also contended that the contemplated statutory vesting rules should vary with the type of employer maintaining the plan, the type of plan involved, the degree of mobility inherently required of employees in particular occupations, and the voluntary or involuntary nature of an employee’s termination.⁶⁷ On the other hand, many management representa-

62. See S. REP. NO. 93-383, *supra* note 19, at 18; H. R. REP. NO. 93-807, *supra* note 19, at 19. Note that plan amendments which have the effect of reducing benefits already accrued by participants are subject to substantial limitations. Section 411 (d) (6) of the Internal Revenue Code provides: “A plan shall be treated as not satisfying the requirements of this section if the accrued benefit of a participant is decreased by an amendment of the plan, other than an amendment described in § 412 (c) (8).” Section 412 (c) (8) allows certain retroactive plan amendments, subject to strict timeliness, procedural, and substantive limitations.

63. S. REP. NO. 93-383, *supra* note 19, at 13.

64. See S. REP. NO. 93-127, 93d Cong., 1st Sess. 20 (1973)[hereinafter cited as S. REP. NO. 93-127].

65. *Senate Finance Hearings*, *supra* note 49, at 345.

66. The suggested compromises included: (1) counting prior service in determining the percentage vested only as to benefits accruing in the future, *Senate Finance Hearings*, *supra* note 49, at 951-52 (pt.2); (2) treating the additional costs attributable to such vesting as a “past service” cost, which could be funded over a fairly long period, *Id.* at 1044; and (3) limiting retroactive vesting credit to employees who have attained at least age 45 by ERISA’s effective date, as proposed by Senate Committee on Labor and Public Welfare, see S. REP. NO. 92-1150, 92d Cong., 2d Sess. 31 (1972) (proposal of the Senate Committee on Labor and Public Welfare). In 1973, however, the Senate Committee on Labor and Public Welfare abandoned the age 45 limitation on retroactive vesting because it tended to be arbitrary. Furthermore, eliminating the age-based cut-off would result in only marginal cost increases—roughly 9% of the current plan cost or 2% of the overall payroll cost. S. REP. NO. 93-127, *supra* note 64, at 20. Some representatives of organized labor even asserted that no pension reform legislation would be acceptable if it did not require retroactivity for both benefit accrual rates and vesting schedules. *Senate Finance Hearings*, *supra* note 49, at 248, 380. Witnesses at the hearings argued, sometimes submitting supporting briefs, that legislation requiring retroactive vesting would not be unconstitutional. *Id.* at 723-42, 839, 1008.

67. S. REP. NO. 93-127, *supra* note 64, at 18-19.

tives advocated alternative vesting schedules to accommodate such factors as the myriad vesting schedules in effect and the varying compositions of different industries' work forces.⁶⁸ Generally, they suggested any schedule be permitted so long as it was as liberal as the statutory standard.⁶⁹ In order to effect that scheme, the department with jurisdiction over minimum vesting could be authorized to grant variances on the basis of comparability.⁷⁰ The various factors measuring comparability were proposed.⁷¹ It was also suggested that Congress permit existing plans to qualify by adopting one of three schedules contained in the various bills,⁷² while requiring plans established in the future to adopt a single statutorily mandated vesting standard.⁷³

The Statute—Proposals and Compromises

The bill passed by the Senate required new plans to adopt a graduated five-to-fifteen year vesting schedule.⁷⁴ Plans in existence on the date of the bill's enactment could retain a ten year "cliff" vesting schedule⁷⁵ if the plan contained such a schedule on and after that date.⁷⁶ The House bill not only offered both of those rules as alternatives, but in addition, permitted the age-weighted "rule of forty-five" discussed below.⁷⁷

The different vesting standards for existing and new plans contained in the Senate bill would have achieved the House goal of providing "adequate flexibility" to the hundreds of thousands of

68. *Senate Finance Hearings*, *supra* note 49, at 275.

69. *Id.* at 275, 392, 858.

70. *H.R. 2 Hearings*, *supra* note 48, at 165, 384, 386-87.

71. *Senate Finance Hearings*, *supra* note 49, at 838-39, 924-25; *H.R. 2 Hearings*, *supra* note 48, at 387.

72. S. 4, 93d Cong., 1st Sess. § 202, 119 CONG. REC. 93 (1973) (30% vested after 8 years of covered service and 10% per year additional vesting thereafter) *reprinted in I LEGISLATIVE HISTORY*, *supra* note 21, at 117-21; S. 1179, 93d Cong., 1st Sess. § 322, 119 CONG. REC. 7415 (1973) (25% after 5 years of plan participation and 5% per year thereafter), *reprinted in I LEGISLATIVE HISTORY*, *supra* note 21, at 235-39; S. 1631, 93d Cong., 1st Sess. § 2 (a), 119 CONG. REC. 12926 (1973) (rule of 50-50% vesting when sum of age and years of participation equals 50 (or upon completion of 3 continuous years of service, if later) and 10% per year thereafter), *reprinted in I LEGISLATIVE HISTORY*, *supra* note 21, at 328-29.

73. *Senate Finance Hearings*, *supra* note 49, at 845, 951. This was similar to the original approach taken in H.R. 2 as introduced. H.R. 2, 93d Cong., 1st Sess. § 203, 119 CONG. REC. 37 (1973) *reprinted in I LEGISLATIVE HISTORY*, *supra* note 21, at 53-56.

74. For an explanation of the "5 to 15 year graduated vesting schedule" *see* text accompanying notes 86-87 *infra*.

75. For an explanation of the "10 year cliff" vesting schedule *see* text accompanying notes 80-85 *infra*.

76. H.R. 4200, 93d Cong., 1st Sess. § 221, 119 CONG. REC. 30428 (1973) as passed the Senate, *reprinted in II LEGISLATIVE HISTORY*, *supra* note 21, at 1901-03.

77. H.R. REP. NO. 93-807, *supra* note 19, at 54.

existing retirement plans. However, in ERISA Congress adopted the House approach requiring all employee pension benefit plans to meet one of three minimum vesting schedules for accrued benefits derived from employer contributions.⁷⁸ These three options must be applied to all of a participant's years of service; composite arrangements employing one rule for certain years of service and another rule for other years are prohibited.⁷⁹

Under the first option, "ten year full" vesting,⁸⁰ an employee with at least ten years of service must have a 100% nonforfeitable right to his "accrued benefit derived from employer contributions";⁸¹ however, the plan may defer all vesting during the first nine years of service.⁸² The "full vesting" option affords participants total vesting protection after the completion of a reasonably short period of service.⁸³ However, this cliff vesting has been criticized because it gives an employer a great incentive to peremptorily dismiss employees rather than absorb the sharp increase in plan costs that occurs when the employees' rights to accrued benefits become 100% vested upon completion of the tenth year of service.⁸⁴ Congress undoubtedly permitted plans to continue cliff vesting schedules because of their inherent simplicity: the extensive record-keeping and consequential high administrative costs which may be involved in accounting for partially vested rights are avoided under this approach.⁸⁵

A second vesting option is the "five-to-fifteen year graduated" schedule under which a participant must have a twenty-five percent nonforfeitable interest in his accrued benefits attributable to em-

78. ERISA, § 203 (a) (2), 29 U.S.C. § 1053 (a) (2) (Supp. V 1975); I.R.C. § 411 (a) (2).

79. Temp. Treas. Reg. § 11.411 (a)-3 (a) (3), 40 Fed. Reg. 51,422 (Nov. 5, 1975).

80. Under the "cliff" or "full vesting" alternative, a participant has no vested right to any of his employer-derived accrued benefits until he satisfies certain service related requirements. When those requirements are met, the participant's rights to the accrued benefits previously credited to him become fully vested. Thereafter, the participant has an immediate and fully vested right to any accrued benefits subsequently derived from employer contributions. MCGILL, FUNDAMENTALS OF PRIVATE PENSIONS 131 (3d ed. 1965) [hereinafter cited as MCGILL].

81. ERISA, § 203 (a) (2) (A), 29 U.S.C. § 1053 (a) (2) (A) (Supp. V 1975); I.R.C. § 411 (a) (2) (A).

82. See note 80 *supra*.

83. H.R. REP. NO. 93-807, *supra* note 19, at 20, 55. For example, once an employee serves 10 years he has greater vesting protection under the 10 year full vesting approach than under a 5 to 15 graduated vesting schedule. This is because under a graduated vesting schedule, a specified percentage of a participant's accrued benefits vests only as specified units of service are completed. MCGILL, *supra* note 80, at 132. Thus, under the latter system a participant may not become fully vested until the beginning of his 16th year of service.

84. Speech by John Hall, Association for Advanced Life Underwriting, at 12 (May 10, 1974); S. REP. NO. 93-383, *supra* note 19, at 46.

85. H.R. REP. NO. 93-807, *supra* note 19, at 55.

employer contributions after five years of service.⁸⁶ For the next five years of service his accrued benefit must vest at the rate of an additional five percent per year so that the participant's interest is fifty percent vested after ten years. During the last five years of service, the accrued benefits must become nonforfeitable at the rate of an additional ten percent per year, resulting in complete nonforfeitability after fifteen years of service. This option permits gradual vesting on an age-neutral basis, unlike the "rule of forty-five" vesting option discussed below. The advantages of the graduated vesting approach lie in its recognition of some vesting at a relatively early point in time and the minimization of cost which results from its gradual nature.⁸⁷

The third alternative is the age-weighted "rule of forty-five,"⁸⁸ a variant of the controversial "rule of fifty" advocated by the Nixon administration.⁸⁹ Under this option, a participant must have a nonforfeitable right to at least fifty percent of his accrued benefits attributable to employer contributions when, after five years of service, the sum of his age and years of service equals forty-five. Thereafter, his nonforfeitable rights must approach full vesting at the rate of ten percentage points for each of the following five years. This option was designed for firms that wish to provide faster vesting for their more mature employees than for their younger employees.⁹⁰ The Senate conferees⁹¹ added to the House bill's rule of forty-five alternative⁹² the requirement that plans grant an employee who completes ten years of service a nonforfeitable interest in at least fifty percent of his accrued benefit at that time, with an additional ten percent vesting for each additional year of service thereafter.⁹³ Nevertheless, there was concern that even the modified rule of forty-five might lead to hiring discrimination against older workers, and

86. ERISA, § 203 (a) (2)(B), 29 U.S.C. § 1053 (a) (2) (B) (Supp. V 1975); I.R.C. § 411 (a) (2) (B).

87. H.R. REP. No. 93-807, *supra* note 19, at 55. See *Hearings on General Tax Reform, Panel Discussions Before the House Comm. on Ways and Means*, 93d Cong., 1st Sess. (pt. 7) (1973).

88. ERISA, § 203 (a)(2)(C), 29 U.S.C. § 1053 (a)(2)(C) (Supp. V 1975); I.R.C. § 411 (a)(2)(C).

89. See S. 1631, 93d Cong., 1st Sess. § 2 (a) (2), 119 CONG. REC. 12926 (1973); *Senate Finance Hearings*, *supra* note 49, at 336 (remarks of Secretary of the Treasury Schultz).

90. H.R. REP. No. 93-807, *supra* note 19, at 19, 55.

91. Because the House and Senate bills were substantially different, conferees from the tax and labor committees of the House and the Senate met for 20 days in executive session to reconcile the inconsistencies. III LEGISLATIVE HISTORY, *supra* note 21, at 4276.

92. See text accompanying note 88 *supra*.

93. 120 CONG. REC. 29940 (1974) (remarks of Sen. Javits), reprinted in III LEGISLATIVE HISTORY, *supra* note 21, at 4764-65.

ten year cliff vesting might prevent participants with an average length of service from obtaining vested benefits.⁹⁴ Consequently, ERISA section 3022 (a)(1)⁹⁵ specifically directs the Joint Pension Task Force⁹⁶ to gather evidence on the operation of these vesting rules in order to determine whether they adequately fulfill the needs of the nation's work force.

The Senate conferees also succeeded⁹⁷ in eliminating the House bill's provisions that would have: (1) phased-in the vesting requirement;⁹⁸ (2) permitted plans to retroactively decrease vested benefits without the consent of the Secretary of Labor;⁹⁹ and (3) permitted, in certain cases, indefinite delays in achieving compliance with the vesting requirements.¹⁰⁰

The Treasury Regulations

While Title II of ERISA, the tax provisions, defines the term "nonforfeitable" only negatively by listing certain *permitted* forfeitures,¹⁰¹ both the temporary and final Treasury regulations provide that:

94. *Id.*

95. 29 U.S.C. § 1222 (a) (1) (Supp. V 1975).

96. The duties assigned under Title III of ERISA to the Joint Pension Task Force are to be carried out by "[t]he staffs of the Committee on Ways and Means and the Committee on Education and Labor of the House of Representatives, the Joint Committee on Internal Revenue Taxation, and the Committee on Finance and the Committee on Labor and Public Welfare of the Senate . . ." ERISA, § 3021, 29 U.S.C. § 1221 (Supp. V 1975).

97. 120 CONG. REC. 29940 (1974) (remarks of Sen. Javits), reprinted in III LEGISLATIVE HISTORY, *supra* note 21, at 4765.

98. H.R. 2, 93d Cong., 2d Sess. § 203 (a) (2) (D) (as passed by the House) (1974), reprinted in III LEGISLATIVE HISTORY, *supra* note 21, at 3975. The House conferees conceded this point for the reason that costs to the employer which would result from financing the minimum vesting standards were expected to be relatively moderate. 120 CONG. REC. 29199 (1974) (remarks of Rep. Ullman), reprinted in III LEGISLATIVE HISTORY, *supra* note 21, at 4675.

99. *Id.* §§ 203 (f) (1), 501, reprinted in III LEGISLATIVE HISTORY, *supra* note 21, at 3978, 4041.

100. *Id.* § 501, reprinted in III LEGISLATIVE HISTORY, *supra* note 21, at 4041.

101. I.R.C. § 411 (a) (3); see also ERISA, § 203 (a) (3), 29 U.S.C. § 1053 (a) (3) (Supp. V 1975). For instance, an otherwise nonforfeitable accrued benefit may be forfeited in the event that a participant dies prior to reaching the plan's normal or early retirement age. I.R.C. § 411 (a) (3) (A); see also ERISA, § 203 (a) (3) (A), 29 U.S.C. § 1053 (a) (3) (A) (Supp. V 1975). This exception to the general rule of nonforfeitability is, in turn, subject to an exception where a survivor annuity is payable as provided in I.R.C. § 401 (a) (11). Note that, historically, while defined contribution plans have not provided for this type of forfeiture, defined benefit plans usually have done so. See Lee, *Joint and Survivor Annuities under ERISA—The Gamble on Survival*, 3 J. CORP. TAX. 241, 242, 244 (1976). Section 3 (19) of ERISA provides, for Title I purposes only, that "[t]he term 'nonforfeitable' when used with respect to a pension benefit or right means a claim obtained by a participant or his beneficiary to that part of an immediate or deferred benefit under a pension plan which arises from the participant's service, which is unconditional, and which is legally enforceable against the plan." 29 U.S.C. § 1002 (19) (Supp. V 1975).

a right to an accrued benefit is considered to be nonforfeitable at a particular time if, at that time and thereafter, it is an unconditional right [with the exception of the statutorily permitted forfeitures] . . . [A] right which, at a particular time, is conditioned upon a subsequent event, subsequent performance, or subsequent forbearance, is a forfeitable right at that time.¹⁰²

In this regard, the legislative history specifically indicates that the minimum nonforfeitable rights to accrued benefits can not be forfeited because of a participant's disloyalty to the employer.¹⁰³ However, the above-quoted Treasury regulation continues: "to the extent that rights are not required to be nonforfeitable to satisfy the minimum vesting standards, or the nondiscrimination standards of §401 (a)(4), they may be forfeited without regard to the limitation on forfeitability required by this section."¹⁰⁴ The regulations offer the following example of the bad boy forfeitures permitted by that clause.

Corporation A's plan provided that an employee is fully vested in his employer-derived accrued benefit after completion of 5 years of service. The plan also provided that, if an employee works for a competitor he forfeits his rights in the plan. Such provision could result in the forfeiture of an employee's rights which are required to be nonforfeitable under section 411 and therefore the plan would not satisfy the requirements of section 411. If the plan limited the forfeiture to employees who completed less than 10 years of service, the plan would not fail to satisfy the requirements of section 411 because the forfeitures under this provision are limited to rights which are in excess of the minimum required to be nonforfeitable under section 411 (a)(2)(A).¹⁰⁵

102. Temp. Treas. Reg. § 11.411 (a)-4 (a), 40 Fed. Reg. 51,423 (Nov. 5, 1975). Treas. Reg. § 1.411 (a)-4 (a), 42 Fed. Reg. 42,326 (Aug. 23, 1977).

103. See notes 19-20 and accompanying text *supra*.

104. Temp. Treas. Reg. § 11.411 (a)-4 (a), 40 Fed. Reg. 51,423 (Nov. 5, 1975). Treas. Reg. § 1.411 (a)-4 (a), 42 Fed. Reg. 42,326 (Aug. 23, 1977), after the language quoted in the text adds:

Rights which are required to be prospectively nonforfeitable under the vesting standards are nonforfeitable and may not be forfeited until it is determined that such rights are, in fact, in excess of the vesting standards. Thus, employees have a right to vest in the accrued benefits if they continue in employment of employers maintaining the plan unless a forfeitable event recognized by section 411 occurs. For example, if a plan covered employees in Division A of Corporation X under a plan utilizing a 10-year-100 percent vesting schedule, the plan could not forfeit employees' rights on account of their moving to service in Division B of Corporation X prior to completion of 10 years of service even though employees are not vested at that time.

105. *Id.* § 11.411 (a)-4 (c) (example 1), 40 Fed. Reg. 51,424 (Nov. 5, 1975). Treas. Reg. § 1.411 (a)-4 (c) (example 1), 42 Fed. Reg. 42,327 (Aug. 23, 1977).

The Treasury drafters' rationale was that, where an employee pension benefit plan grants a more liberal rate of vesting than required under ERISA, then such extra vesting may revert to one of the statutory minimums, *e.g.*, no vesting until ten years of service have been completed, if the participant in question should violate the plan's bad boy clause.¹⁰⁶ Clearly, the same reasoning would apply to the validity of bad boy clauses during the interim period between the effective date of the preemption section and the vesting provisions.

In a National Office Technical Advice Memorandum,¹⁰⁷ the Internal Revenue Service recently considered a plan which provided ten year graduated vesting, a more liberal schedule than required by ERISA. Under the plan, a participant who had completed less than ten years of service would forfeit his otherwise vested benefits if he violated the bad boy clause. The Service's district office took the position that the plan would not qualify unless it was shown, using the ten year cliff alternative, that the plan would be able to meet the nondiscrimination requirements of section 401 (a)(4).¹⁰⁸ The taxpayer argued that the bad boy clause was not inherently discriminatory.

The National Office pointed out that the example in the temporary regulations was based on the rule that rights may not be forfeited which are required to be nonforfeitable in order to satisfy the minimum vesting standard or the nondiscrimination requirements. Consequently, the Office concluded that the taxpayer must demonstrate the plan would satisfy the *nondiscrimination requirements* of section 401 (a)(4), using the ten year cliff vesting alternative in order to qualify under section 401(a). However, the memorandum does not indicate whether the requisite demonstration could be satisfied by proving that the forfeitures resulting solely from application of the bad boy clause would not be twice as high¹⁰⁹ among the rank-and-file employees as among employees in the prohibited group. A

106. *Credited Service*, *supra* note 44, at 465.

107. A copy of the Memorandum is on file with the author.

108. I.R.C. § 401(a)(4).

109. Rev. Proc. 75-49, 1975-2 C.B. 584, provides in part, if the turnover rate among the rank-and-file employees is more than twice the turnover rate among the prohibited group, then more rapid vesting than the statutory minimum will be required, *i.e.*, 40% after 4 years of employment, 45% after 5 years, 50% after 6 and 10% per year thereafter—the "four-forty" vesting schedule. However, until the company has achieved 5 years of work experience more liberal turnover rules apply. This approach to turnover suggests that in applying a discrimination test to a bad boy clause, it might be appropriate to compare the rates of forfeitures among the rank-and-file and prohibited groups that result solely from application of the plan's bad boy clause, and not those that result merely from the all-or-nothing nature of the 10 year cliff vesting approach.

more burdensome alternative would require a showing that forfeitures would be within those limits even after application of both the plan's ten year vesting schedule and its bad boy clause. Moreover, because of the given facts the memorandum does not address the question whether the plan sponsor of a pre-ERISA plan could show that a post-ERISA graduated vesting schedule, subject to a bad boy clause, would satisfy the nondiscrimination requirements of section 401 (a), where the pre-ERISA vesting schedule was the same and the pre-ERISA plan contained a bad boy clause.¹¹⁰

The drafters of the regulations did not address and probably did not consider the threshold question whether bad boy provisions would be enforceable at all under federal common law after the effective date of the ERISA preemption provisions. The search for an answer to that question entails an examination of the preemption doctrine and, in particular, the scope of ERISA's preemption provisions.

ERISA'S PREEMPTION PROVISIONS

The preemption doctrine has been described¹¹¹ as the means for determining how regulatory authority has been allocated between the states and the federal government under the supremacy clause of the Constitution.¹¹² Generally, two tests are applied by the judiciary to determine whether state law has been preempted: whether state regulation would "conflict" with the federal regulation in question, and whether Congress intended to "occupy" the area in question to the exclusion of the states.¹¹³ As regards the conflict test, the cases finding that state law has been preempted

110. In the wake of criticism of the position taken by the Service in Rev. Proc. 75-49, 1975-2 C.B. 584, (see *Credited Service*, *supra* note 44, at 382-83), the Service retreated. Rev. Proc. 76-11, 1976-1 C.B. 550, in effect, created a grandfather clause for pre-ERISA plans. A safe harbor is granted:

in the case of any plan which had previously been the subject of a favorable advance determination letter which has not been revoked, [so long as] the percentage of vesting of each participant provided under the plan, as amended, is not less (at every point) than that provided under the vesting schedule of the plan upon which such most recent prior determination letter was based. . . .

Arguably, a plan would meet this test, even though employing a 10 years of service graduated vesting schedule that was subject to forfeiture for bad boy activities engaged in before completion of 10 years of service, where the prior plan had a 10 years of *participation* graduated vesting schedule, with a similar bad boy clause. The author has successfully employed this argument in obtaining a favorable advance determination letter.

111. See generally Note, *The Preemption Doctrine: Shifting Perspectives on Federalism and the Burger Court*, 75 COLUM. L. REV. 623 (1975) [hereinafter cited as *Preemption Doctrine*].

112. U.S. CONST. art. VI, cl. 2.

113. *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1946). See generally *Preemption Doctrine*, *supra* note 111, at 624-39.

tend to fall into one of two categories: (1) those that reflect the concern that "one forum would enjoin, as illegal, conduct which the other forum would find legal" and those that reflect the concern "that the [application of state law by] state courts would restrict the exercise of rights guaranteed by the Federal Acts."¹¹⁴

The occupation test, in turn, focuses upon whether Congress intended to foreclose state regulation in a particular field.¹¹⁵ Where Congress is silent, the courts have found preemption where a clear *implication* of congressional intent to occupy the field can be shown.¹¹⁶ However, Congress may also state such an intent directly,¹¹⁷ as it did in section 514 of ERISA, which took effect on January 1, 1976.¹¹⁸

Section 514 (a) provides that Title I of ERISA,¹¹⁹ the labor title, and Title IV,¹²⁰ the termination insurance provisions, shall "superseede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan. . . ."¹²¹ Section 514 (c)(1), in turn, defines the term "state law" to include "all laws, decisions, rules, regulations, or other State action having the effect of law, of any State."¹²² It is beyond question that Congress intended by this provision to make federal law the sole authority regulating the field of employee benefit plans.¹²³ The scope of federal regulation clearly includes areas such as reporting and disclosure requirements¹²⁴ and fiduciary obligations,¹²⁵ generally effective January 1, 1975.¹²⁶ It also encompasses the application of ERISA's nonforfeitability provisions,¹²⁷ to plans in existence on January 1, 1974, for plan years beginning after December 31, 1975.¹²⁸ A more difficult question is whether state law, under the *Erie* doctrine,¹²⁹ or whether federal

114. *Machinists v. Wisconsin Emp. Rel'ns Comm'n*, 427 U.S. 132, 138 (1976). See *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941).

115. *Florida Avocado Growers v. Paul*, 373 U.S. 132, 146 (1963).

116. *Cloverleaf Butter Co. v. Patterson*, 315 U.S. 148, 157 (1942). For a discussion of the factors used to determine the implied congressional intent see note 145 *infra*.

117. See, e.g., *Emergency Petroleum Allocation Act*, § 6 (b), 15 U.S.C. § 755 (b) (Supp. V 1975).

118. ERISA, § 514 (a), 29 U.S.C. § 1144 (a) (Supp. V 1975).

119. 29 U.S.C. §§ 1001-1144 (Supp. V 1975).

120. *Id.* §§ 1301-1381.

121. *Id.* § 1144 (a). The full text of § 514 is set out in note 10 *supra*.

122. *Id.* § 1144 (c) (1).

123. 120 CONG. REC. 29197 (1974) (remarks of Rep. Dent), reprinted in III LEGISLATIVE HISTORY, *supra* note 21, at 4670-71.

124. ERISA, tit. I, part 1, 29 U.S.C. §§ 1021-31.

125. *Id.* tit. I, part 4, 29 U.S.C. §§ 1101-14.

126. *Id.* §§ 111 (b) (1), 414 (a), 29 U.S.C. §§ 1031 (b) (1), 1114 (a).

127. *Id.* tit. I, part 2, 29 U.S.C. §§ 1051-61.

128. *Id.* § 211 (b) (2), 29 U.S.C. § 1061 (b) (2).

129. *Erie R. Co. v. Tompkins*, 304 U.S. 64 (1938).

common law¹³⁰ applies to bad boy clauses during the gap period between the respective effective dates of ERISA's preemption and nonforfeitability provisions. Clearly, where federal statutes determine rights and liabilities, federal common law rather than state law applies.¹³¹ The *Erie* doctrine "is inapplicable to those areas of judicial decision within which the policy of the law is so dominated by the sweep of federal statutes that legal relations which they effect must be deemed governed by federal law having its source in those statutes, rather than by local law."¹³²

The ERISA Conference Report stated that all actions to enforce benefit rights or to recover benefits under a plan "are to be regarded as arising under the laws of the United States in similar fashion to those actions brought under section 301 of the Labor-Management Relations Act of 1947,"¹³³ which the Supreme Court has held are subject to a federal common law.¹³⁴ The development of federal common law under section 301 of the Labor-Management Relations Act of 1947¹³⁵ indicates that courts are required to examine the policy of the federal legislation. They may also refer to state law if it is compatible with the federal policy.¹³⁶ Senator Javits, in the floor debate on the conference bill, stated that it was intended "that a body of Federal substantive law be developed by the courts to deal with issues involving rights and obligations under private welfare and pension plans."¹³⁷

Another convincing indication that federal substantive law should be used to interpret and enforce employee benefit plan terms is the development of the preemption provision in the various House

130. See notes 36-40 and accompanying text *supra*.

131. *Thurber v. Western Conf. of Teamsters Pension Plan*, 542 F.2d 1106, 1108 (9th Cir. 1976).

132. *Sola Elec. Co. v. Jefferson Elec. Co.*, 317 U.S. 173, 176 (1942); *accord*, *Clearfield Trust Co. v. United States*, 318 U.S. 363, 366 (1943).

133. H.R. REP. NO. 93-1280, 93d Cong., 2d Sess. 327 (1974).

134. *Textile Workers v. Lincoln Mills*, 353 U.S. 448, 456-57 (1957).

135. Section 301 (a) provides:

(a) Suits for violation of contracts between an employer and a labor organization representing employees in an industry affecting commerce as defined in this chapter, or between any such labor organizations, may be brought in any district court of the United States having jurisdiction of the parties, without respect to the amount in controversy or without regard to the citizenship of the parties.

29 U.S.C. § 185 (a) (1970).

136. *Textile Workers v. Lincoln Mills*, 353 U.S. 448, 457 (1957). *Lincoln Mills* held that a federal common law should be fashioned under § 301 (a) of the Labor-Management Relations Act of 1947.

137. 120 CONG. REC. 29942 (1974), reprinted in III LEGISLATIVE HISTORY, *supra* note 21, at 4771.

and Senate bills. House Resolution 2, the bill passed by the House, provided that, *except for actions brought by a participant or beneficiary to recover benefits due him under the terms of his plan or to clarify his rights to future benefits under the terms of the plan*, the labor provisions of H.R. 2 preempted state laws "insofar as they may now or hereafter relate to the reporting and disclosure responsibilities, of persons acting on behalf of any employee benefit plan to which part 1 applies."¹³⁸ A separate subsection preempted state laws that related to *nonforfeitability of participants' benefits*, funding requirements, adequacy of financing, portability requirements, or insurance of pension benefits.¹³⁹

The Nixon administration's bill¹⁴⁰ was structured similarly, although it more explicitly left to state law the interpretation of the plan document insofar as it related to the amount of benefits due a particular participant. At the Senate Finance Committee Hearings, a Department of Labor representative interpreted this bill to mean that state law would apply to actions brought by participants and beneficiaries to recover benefits due under the plan or to clarify rights to future benefits.¹⁴¹

In contrast, the bill passed by the Senate¹⁴² preempted any and all state laws relating to matters regulated by ERISA. Section 699 (b) of that bill permitted state court jurisdiction in any action by a fiduciary seeking an interpretation of the plan documents. However, in such actions, state laws would be superseded to the extent they related "to the fiduciary, reporting and disclosure responsibilities of persons acting for or on behalf of employee benefit plans . . . *except insofar as they may relate the amount of benefits due beneficiaries under the terms of the plan.*"¹⁴³ Because the exceptions and restrictions contained in the prior bills were discarded, the absolute language of ERISA section 514 would, under traditional statutory construction, apply to suits for benefits requiring interpretation of plan terms.¹⁴⁴ From this history, it appears that the scope of ERISA's

138. H.R. 2, 93d Cong., 2d Sess. § 514 (a) (as passed by the House) 119 CONG. REC. 4782 (1974), reprinted in III LEGISLATIVE HISTORY, *supra* note 21, at 4057.

139. *Id.* § 514 (c), reprinted in III LEGISLATIVE HISTORY, *supra* note 21, at 4058-59.

140. S. 1557, 93d Cong., 1st Sess. § 14, 119 CONG. REC. 12061, 12075 (1973) reprinted in I LEGISLATIVE HISTORY, *supra* note 21, at 319-21.

141. *Senate Finance Hearings*, *supra* note 49, at 449 (written statement of the Department of Labor, presented by Paul J. Fasser, Assistant Secretary of Labor for Labor-Management).

142. H.R. 4200, 93d Cong., 1st Sess. § 699, 119 CONG. REC. 30428 (as passed by the Senate) (1973), reprinted in II LEGISLATIVE HISTORY, *supra* note 21, at 2103-05.

143. *Id.* § 599 (b) (emphasis added).

144. *Nat'l Automatic Laundry and Cleaning Council v. Shultz*, 443 F.2d 689, 706 (D.C. Cir. 1971); *cf. Gulf Oil Corp. v. Copp Paving Co.*, 419 U.S. 186, 199-200 (1974) (finding that a conference committee's deletion of an expansive phrase in § 2 (a) of the House version of

preemption includes state law interpretation of employee benefit plan provisions. Thus, federal common law interpreting such provisions must develop.¹⁴⁵

Congress could have drafted the ERISA preemption provision to apply piecemeal as the various substantive areas became effective, but it did not do so. Consequently, the clear language and the legislative intent of the preemption provision, under established precedent concerning federal common law, strongly support the *Amory* court's holding that during the interim period the effect and operation of bad boy clauses may not be judged by pre-existing state law, but must be governed by a federal common law to be derived from ERISA. However, the determination of whether *Amory* correctly derived such federal law requires an examination of the general pre-ERISA state law regarding bad boy clauses, the policies underlying ERISA, and the interplay between those two concerns.

PRE-ERISA STATE BAD BOY AUTHORITY

Discharge for Cause

Prior to ERISA, few cases involved employer attempts to deny private sector employees their otherwise vested retirement benefits as punishment for their misconduct or dishonesty,¹⁴⁶ rather than competitive behavior. However, in recent years, perhaps due to the growth of the private pension market, more cases have considered the former issue, and have generally upheld those provisions.¹⁴⁷ For

the Robinson-Patman Act "strongly militates against a judgment that Congress intended a result that it expressly declined to enact."); *Tri-Lakes S.S. Co. v. Comm'r*, 146 F.2d 970, 972 (6th Cir. 1945) ("It has long been a recognized rule of statutory construction that the omission by amendment, of qualifying language, discloses an intent to include the class previously excluded by the omitted qualifying language.").

145. *Lee*, *supra* note 1, at 47. Apart from the portions of the legislative history discussed in the text that deal with explicit congressional preemption concerning vesting and bad boy clauses during the gap period, other parts of the legislative history would, under *Rice v. Santa Fe Elev. Corp.*, 331 U.S. 218, 230 (1947), and *Burbank v. Lockheed Air Terminal*, 411 U.S. 624, 633 (1973), support a conclusion of implied preemption in view of: (1) the pervasiveness of federal regulation; (2) the objectives and effects of character of federal and state regulation; (3) the dominant national or federal interest in the field; and (4) the need for uniformity of regulation. The legislative history of ERISA clearly shows the presence of all of these factors, particularly the need for national uniformity in order to eliminate conflicting and inconsistent state regulation. 120 CONG. REC. 29197 (1974) (remarks of Rep. Dent), *reprinted in III LEGISLATIVE HISTORY*, *supra* note 21, at 4670. *See S. REP. No. 93-127*, 93d Cong., 1st Sess. 29 (1973).

146. *See, e.g., Lamphere v. Old Second Nat'l Bank*, 39 Ill. App. 3d 610, 350 N.E.2d 272 (1976); *Annot.*, 76 A.L.R.2d 568 (1966).

147. *Taylor v. Gen. Tel. Co.*, 20 Cal. App. 3d 70, 97 Cal. Rptr. 349 (1971); *Bird v. Connecticut Power Co.*, 144 Conn. 456, 133 A.2d 894 (1957); *White v. Crane Co.*, 147 So. 2d 32 (Ct. App. La. 1962); *Marcus v. Boston Edison Co.*, 56 N.E.2d 910 (Sup. Ct. Mass. 1944); *Gitelson v. Dupont*, 17 N.Y.2d 46, 215 N.E.2d 336 (Ct. App. 1966); *Taint v. Kroger Co.*, 47 Ohio Op.2d

example, a California court¹⁴⁸ allowed a denial of benefits to a death beneficiary even though the acts of dishonesty in question were not discovered until after the participant's death. Moreover, in 1970, the Texas Supreme Court¹⁴⁹ held that a retirement plan committee's determination of a participant's termination for dishonest conduct is conclusive absent a showing of a lack of good faith in the application of the plan's provisions.¹⁵⁰ Lack of good faith was not shown by either the committee's reliance on an attorney's definition of dishonesty or in its failure to hold a hearing, because none was requested since the participant admitted the conduct in question.¹⁵¹ However, recent decisions have construed "discharge for cause" bad boy clauses very narrowly. For example, where a former participant's embezzlement and disclosure of trade secrets were not discovered until *after* termination of employment, his termination was not considered a "discharge for cause."¹⁵² Similarly, a provision forfeiting an employee's vested interest upon "confessions" to a felony or misdemeanor was held to require "confession" in the strict criminal law sense.¹⁵³

Post-termination Competitive Behavior

Most pre-ERISA litigation concerning divestitures of vested rights was generated by post-termination competitive behavior. Plans commonly provided that a participant's retirement benefits would be reduced or terminated if, after retirement or termination of employment, the participant engaged in conduct that was com-

272, 247 N.E.2d 794 (Ct. C.P. 1967); *Ellis v. Atlantic Coast Line R.R.*, 172 S.C. 338, 174 S.E. 19 (1934). *But see* *Leongard v. Metal & Thermit Corp.*, 204 F. Supp. 74 (S.D.N.Y. 1962). *See generally* Note, *Pension Plans and the Rights of the Retired Worker*, 70 COLUM. L. REV. 909, 917-18 (1970). *Cf.* *Lieberman v. Cook*, 343 F. Supp. 558 (W.D. Pa. 1972).

148. *Reese v. Administrative Comm. of Profit-Sharing Trust*, 218 Cal. App.2d 646, 32 Cal. Rptr. 818 (1963).

149. *Neuhoff Bros. Packers Mgm't Corp. v. Wilson*, 453 S.W.2d 472 (Tex. 1970). In *Neuhoff*, the profit-sharing plan: (1) mandated forfeiture of a participant's entire account balance in the event of termination for dishonest or fraudulent conduct; (2) granted to the plan committee authority to make all determinations concerning a particular participant's benefits; and (3) stated that the committee's decisions would be final, binding, and conclusive on all parties.

150. For a discussion of the validity of the court's standard of review in light of the prohibition against exculpatory clauses found in ERISA, § 410 (a), 29 U.S.C. § 1110 (a) (Supp. V 1975), *see* Lee, (ERISA)-Fiduciary Responsibilities and Prohibited Transactions, A-37 (Tax Mgm't Portfolio number 308, 1975).

151. 453 S.W.2d 472, 474-75 (1970); *accord*, *Miller v. Assoc. Pension Trusts, Inc.*, 541 F.2d 726, 729 (8th Cir. 1976).

152. *See* *Lamphere v. Old Second Nat'l Bank*, 39 Ill. App. 3d 610, 350 N.E.2d 272 (1976); *accord*, *Anger v. Bender*, 31 Ill. App. 3d 877, 335 N.E.2d 122 (1975).

153. *Helzer v. Mountain States Motors, Inc.*, 535 P.2d 517 (Ct. App. Colo. 1975).

petitive with, or detrimental to, his former employer's business.¹⁵⁴ The early cases often permitted forfeitures on the theory that a pension constituted a gratuity; thus, the employer could make or withhold these gratuitous pension payments as he chose.¹⁵⁵ More recently, however, virtually all of the authorities have recognized that retirement benefits, whether provided under a contributory or non-contributory retirement plan,¹⁵⁶ are in reality *earned* by the employee, since the payments are in lieu of compensation. Hence, pension benefits constitute deferred wages.¹⁵⁷

1. Policy Considerations

Unfortunately, a number of theories and approaches relied upon by courts sustained anticompetition retirement plan provisions but failed to address underlying policy questions. For example, some courts based their validations of forfeiture clauses upon factors such as whether the employee's interest vested periodically or only upon termination of employment,¹⁵⁸ and whether a participant had failed to comply with another contract provision, thereby empowering the employer to revoke its pension promise.¹⁵⁹

2. "Employee's Choice" Rationale

The majority of pre-ERISA cases upheld anticompetition clauses in retirement plans under an "employee's choice" rationale: such provisions place no restraint upon the freedom of the employee, because they do not prevent the employee from accepting employment with a competitor—he has a choice between the new job or the retirement benefits.¹⁶⁰

154. See, e.g., *Rochester Corp. v. Rochester*, 450 F.2d 118, 123 (4th Cir. 1971); *Keller v. Graphic Systems, Inc.*, 422 F.Supp. 1005, 1007 (N.D. Ohio 1976); *Van Pelt v. Berefco, Inc.*, 60 Ill. App. 2d 415, 308 N.E.2d 858, 865 (1965).

155. *Forfeiture of Benefits*, *supra* note 50, at 296.

156. The terms "contributory" and "non-contributory" distinguish between those plans that provide benefits to participants regardless of investment of their own money in the funding vehicle and those plans which impose sanctions for a failure to so invest. See generally ERISA, § 204 (c) (2) (C), 29 U.S.C. § 1054 (c) (2) (C) (Supp. V 1975), where the term "mandatory contributions" is defined as "amounts contributed to the plan by the employee which are required as a condition of employment, as a condition of participation in such plan, or as a condition of obtaining benefits under the plan attributable to employer contributions."

157. See authorities cited at note 50 *supra*.

158. *Koehn & Ptacek*, *supra* note 53, at 83-88.

159. *Forfeiture of Benefits*, *supra* note 50, at 292.

160. *Rochester Corp. v. Rochester*, 450 F.2d 118, 122-23 (4th Cir. 1971); *accord*, *Bannert v. American Can Co.*, 525 F.2d 104, 109 (6th Cir. 1975); *Golden v. Kentile Floors, Inc.*, 512 F.2d 838, 843-44 (5th Cir. 1975); *Keller v. Graphic Systems, Inc.*, 422 F. Supp. 1005, 1012 (N.D. Ohio 1976); *Miller v. Associated Pension Trusts, Inc.*, 396 F. Supp. 907, 911 (E.D. Mo. 1975), *aff'd*, 541 F.2d 726 (8th Cir. 1976); *Brown Stove Works, Inc. v. Kimsey*, 119 Ga. App.

Commentators strongly criticized the employee's choice analysis.¹⁶¹ Eventually, some courts¹⁶² voiced similar criticism:

The idea that under such forfeiture provisions an employee has a real "freedom of choice" has been strongly criticized upon the ground that even under noncontributory pensions [*sic*] plans, benefit payments are no longer regarded as "gratuities," but as a contractual right to deferred compensation, and that these decisions ignore the inhibitory effect of such a forfeiture clause upon an employee in making the decision whether to accept a new job, in that ordinarily the new employment will not compensate him for loss of the pension, which may represent a substantial portion of what he must depend upon when he retires and which he cannot risk by competing.¹⁶³

3. The "Reasonableness" Test

Gradually, the pre-ERISA cases began to equate anticompetition clauses in retirement plans with those contained in employment contracts. These courts recognized that under the latter clause the employer was forced to employ legal sanctions against competing employees while under the former clause the employer could deny competing employees their retirement benefits. It was reasoned that "in either instance, the employee is subject to an economic loss should he breach the restrictive covenant."¹⁶⁴ Though this position continued to be the minority view,¹⁶⁵ the significance of the equation

453, 167 S.E.2d 693 (1969); *Van Pelt v. Berefco, Inc.*, 60 Ill. App.2d 415, 208 N.E.2d 858, 865 (1965); *Alco-Columbia Paper Serv., Inc. v. Nash*, 273 So.2d 630, 632 (La. Ct. App. 1973); *Allredge v. City Nat'l Bank*, 468 S.W.2d 1 (Mo. 1971); *Dollgener v. Robertson Fleet Servs., Inc.*, 527 S.W.2d 277 (Tex. Civ. App. 1975). See generally Annot., 18 A.L.R.3d 1246, 1251-55 (1968).

The employee choice doctrine, as it originated in New York, see *Kristt v. Whelan*, 4 A.D.2d 195, 164 N.Y.S.2d 239 (Ct. App. 1957), *aff'd*, 5 N.Y.2d 807, 181 N.Y.S.2d 205, 155 N.E.2d 116 (1958), implied that such a forfeiture may never be examined for reasonableness. See *Amory v. Boyden Associates, Inc.*, 434 F. Supp. 671, 672 n.1 (S.D.N.Y. 1976). The strength of this doctrine may have been somewhat eroded by subsequent decisions. See *Golden v. Kentile Floor, Inc.*, 512 F.2d 838, 844 (5th Cir. 1975).

161. See, e.g., *Forfeiture of Benefits*, *supra* note 50, at 303; Case Note, 50 CORNELL L.Q. 672, 676-77 (1965).

162. Compare, *Flammer v. Patton*, 245 So.2d 854, 858 (Fla. 1971); *Food Fair Stores, Inc. v. Greeley*, 264 Md. 105, 285 A.2d 632 (1972); *Woodward v. Cadillac Overall Supply Co.*, 396 Mich. 379, 240 N.W.2d 710 (1976); *Harris v. Bolin*, 247 N.W.2d 600 (Minn. 1976); *Lavey v. Edwards*, 264 Ore. 331, 505 P.2d 342, 345 (1973); *Almers v. South Carolina Nat'l Bank*, 217 S.E.2d 135 (S.C. 1975); *Sheppard v. Blackstock Lumber Co.*, 85 Wash.2d 929, 540 P.2d 1373 (1975); *Estate of Schroeder v. Gateway Transp. Co.*, 53 Wis.2d 59, 191 N.W.2d 860 (1971); with authorities cited in note 147 *supra*, and *Collister v. Board of Trustees of the McGee Co. Profit Sharing Plan*, 531 P.2d 989 (Colo. Ct. App. 1975); *Hudson v. North Carolina Farm Bureau*, 23 N.C. App. 50, 209 S.E.2d 416 (1974).

163. *Lavey v. Edwards*, 264 Ore. 33, 505 P.2d 342, 345 (1973).

164. See *Food Fair Stores, Inc. v. Greeley*, 264 Md. 105, 285 A.2d 632 (1972).

165. See *Almers v. South Carolina Nat'l Bank*, 217 S.E.2d 135, 138 (S.C. 1970).

was threefold. First, in some jurisdictions, all anticompetition restrictions were *statutorily* voided as restraints on trade, at least where they were not necessary to protect the employer's interests.¹⁶⁶ Second, under the common law in some states, the enforceability of contractual divestiture depended on the restraint's compliance with a "reasonableness" test, *i.e.*, whether it was (1) necessary to protect the employer's interest in view of the detriment to the employee, and (2) not harmful to the public.¹⁶⁷

Third, some jurisdictions, in applying the reasonableness standard, focused upon the potential injury to the public and, consequently, voided bad boy clauses as being "so unreasonable as to be in violation of public policy."¹⁶⁸ For example, the Iowa Supreme Court reasoned in *Van Hosen v. Bankers Trust Co.*:¹⁶⁹

[W]hen a career employee retires, either voluntarily or involuntarily, he or she often experiences a traumatic economic change. Furthermore, many pensioners cannot, at the moment, qualify for social security and must resort to other employment for supplementary income. Usually, in such cases, work openings in the employee's accustomed field of endeavor are not readily available. And if such a position is obtained, comparatively inconsequential or no attendant marginal benefits are ordinarily provided, or ultimately acquired.

* * *

[W]hen retirement from any subsequent employment occurs the result can be chaotic, absent restoration of any pension rights

166. *Muggil v. Reuben H. Donnelley Corp.*, 62 Cal. 2d 239, 42 Cal. Rptr. 107, 348 P.2d 147, 18 A.L.R.2d 1241 (1965); *Flammer v. Patton*, 245 So.2d 854 (Fla. 1971); *Graham v. Hudgins, Thompson, Ball & Assoc., Inc.*, 540 P.2d 1161 (Okla. 1975); *Holsen v. Marshall & Ilsley Bank*, 52 Wis. 2d 281, 190 N.W.2d 189 (1971).

167. See *Lavey v. Edwards*, 264 Ore. 331, 505 P.2d 342 (1973); accord, *Woodward v. Cadillac Overall Supply Co.*, 396 Mich. 379, 240 N.W.2d 710 (1976); *Sheppard v. Blackstock Lumber Co.*, 85 Wash. 2d 929, 540 P.2d 1373 (1975). See generally Black, *Employee Agreements not to Compete*, 73 HARV. L. REV. 625, 626-27 (1960); Koehn & Ptacek, *supra* note 53 at 92-93. The courts generally construe any ambiguity in favor of the former participant. See, e.g., *Paddock Pool Constr'n Co. v. Monseur*, 23 Ariz. App. 451, 533 P.2d 1188 (1975).

168. *Van Hosen v. Bankers Trust Co.*, 200 N.W.2d 504 (Iowa 1971); accord, *Food Fair Stores, Inc. v. Greeley*, 264 Md. 105, 285 A.2d 632 (1972); *Woodward v. Cadillac Overall Supply Co.*, 396 Mich. 379, 250 N.W.2d 710, 721 (dissenting opinion) (1976); *Almers v. South Carolina Nat'l Bank*, 217 S.E.2d 135, 139 (S.C. 1975). The countervailing policy, under the majority view, is apparently based upon freedom of contract principles. *Dollgener v. Robertson Fleet Services, Inc.*, 527 S.W.2d 277, 280 (Tex. Civ. App. 1975). This approach, however, overlooks the disparate bargaining power of the employer and employees. Furthermore, it ignores the reality that many plans are not negotiated, but are unilaterally established by the employer. *Woodward v. Cadillac Overall Supply Co.*, 395 Mich. 379, 240 N.W.2d 710 (dissenting opinion) (1976).

169. 200 N.W.2d 504 (Iowa 1971).

170. *Id.* at 508-09.

acquired through extended service with a prior employer. The harshness of such a situation is self-evident.

Moreover, private pension plans have a humanitarian purpose in that, like employment security, they extend to those benefitted some degree of financial independence at a time when earning ability and related income may be impaired or ended . . . It is in turn evident these programs have become increasingly vital to our socioeconomic community welfare. By the same token society today has a material interest in the orderly development and administration of all pension plans, public or private. Thus public policy comes into play. . . .

It therefore follows, the infinite forfeiture and termination of all pension rights instantly acquired by plaintiff through prior affiliation with defendant bank, merely by accepting employment with a competing institution, imposes an unjust and uncivic penalty on plaintiff at the same time disproportionately benefitting these defendants.¹⁷⁰

In those jurisdictions espousing the majority view that competitive behavior bad boy clauses were not void as against public policy, commentators disagreed¹⁷¹ on the issue whether courts should rewrite unreasonable anticompetition clauses. The majority of the courts that considered the issue reformed such clauses, and enforced them when the employee's competitive conduct surpassed the ambit of a reasonable restraint.¹⁷² In contrast, a frequent pre-ERISA statutory approach was to void entirely unreasonable anti-competitive clauses, rather than to allow enforcement of the reasonable portion.¹⁷³

4. Time of Payment Considerations

When pre-ERISA bad boy clauses were voided, questions arose concerning the appropriate time for payment of vested plan benefits. Frequently, under pre-ERISA retirement plans, benefit payments did not begin until a terminated or retired employee reached normal retirement age. On rare occasions, when the plan committee

171. Compare *Forfeiture of Benefits*, supra note 50, at 299, with Koehn & Ptacek, supra note 53, at 94. This approach would parallel the common law approach toward general anti-competition clauses in employment contracts. *Forfeiture of Benefits*, supra note 50, at 299.

172. *Flammer v. Patton*, 245 So.2d 854 (Fla. 1971); *Lavey v. Edwards*, 264 Ore. 331, 505 P.2d 342 (1973); *Sheppard v. Blackstock Lumber Co.*, 85 Wash.2d 929, 540 P.2d 1373 (1975). *Contra*, *Woodward v. Cadillac Overall Supply Co.*, 396 Mich. 379, 240 N.W.2d 710 (1976); *Harris v. Bolin*, 247 N.W.2d 600 (Minn. 1976).

173. See *Woodward v. Cadillac Overall Supply Co.*, 396 Mich. 379, 240 N.W.2d 710 (1976) ("It is also significant that some states have promulgated statutes which specifically limit the validity of non-competition forfeitures. Moreover, under these statutes, unlimited non-competition forfeiture clauses have invariably been held invalid.").

or trustee unsuccessfully attempted to divest a terminated employee of his vested benefits a question remained whether he would be entitled to receive his benefits earlier than scheduled. For example, in *Food Fair Stores, Inc. v. Greeley*,¹⁷⁴ the plan provided that a participant who voluntarily terminated his employment would not be eligible to receive benefit payments until normal retirement. However, the Maryland Supreme Court ruled that a former participant who had not reached that age was entitled to immediate payment where his account balance had been wrongfully forfeited for alleged competitive activities and transferred to the accounts of the remaining participants. After invalidating the anti-competition clause as impermissibly broad, the court reasoned that the transfer of the participant's account balance constituted a commingling of his allocated assets with the general plan fund, thus amounting to a conversion which entitled him to immediate recovery of their value. While possibly justifiable on public policy grounds, this approach ignores the realities facing modern retirement plans: even in individual account plans funds are usually commingled. Only in the trustee's records are separate accounts established.

However, the legal theory adopted by the *Greeley* court appears to be determinative in this area. Thus in *Bird v. Computer Technology, Inc.*,¹⁷⁵ the terminated employee argued that the employer's stated intent not to pay him any benefits even when he reached normal retirement age constituted a repudiation and anticipatory breach of the pension promise. The court denied the plaintiff's request for immediate payment because under local law an anticipatory breach did not entitle plaintiff to acceleration of future installment payments of money.¹⁷⁶ In most states, however, a terminated employee could treat such an anticipatory repudiation as a breach of contract and receive the actuarial present value of his retirement benefits.¹⁷⁷

Another common plan feature allows a *discretionary* deferral of payment of a terminated participant's vested benefits until normal retirement age. The object of this approach is to preclude an employee from terminating employment and using his plan benefits to

174. 264 Md. 105, 285 A.2d 632, 640 (1972).

175. 364 F. Supp. 1336 (S.D.N.Y. 1973).

176. *Id.* at 1345 ("[T]he doctrine of anticipatory breach has no application [under New York law] to contracts for the payment of money only, in installments or otherwise.").

177. See *Minnesota Amusement Co. v. Larking*, 299 F.2d 142, 153 (8th Cir. 1962); *Stopford v. Boonton Molding Co.*, 56 N.J. 169, 265 A.2d 657 (1970); Annot., 46 A.L.R.3d 464 (1972).

finance a competitive business. But, in one pre-ERISA case,¹⁷⁸ the fiduciaries' decision to withhold payment of the terminated participant's vested benefits until normal retirement age was held an abuse of discretion, since the decision was motivated solely by the fiduciaries' fear that the employee would compete with his former employer.

The interplay of the pre-ERISA state law concerning bad boy clauses with the policies underlying ERISA may now be examined in an effort to discern the viability of such forfeiture clauses during the gap period.

ERISA COMMON LAW

The district court in *Amory* fashioned its own "reasonableness test" for construing bad boy clauses. In light of the public policy expressed in the legislative history of ERISA, at a minimum the standard for bad boy clauses should be rigorous: they should be presumed unreasonable unless the plan administrator carries the burden of proving otherwise. The *Amory* court concluded that the following questions would have to be considered.

[I]n light of such reasonableness standard:

1. Were the textual provisions of the contract reasonable in scope?
2. Were those provisions, if reasonable, properly applied?
3. Was it conscionable to have a decision concerning forfeiture made by persons in a position to profit at plaintiff's expense, and if so, what remedies are now open to the respective parties?¹⁷⁹

However, the court noted that the third factor might cease to be important, since, under emerging federal common law, the employer has the burden of proving the forfeiture provision was reasonably applied regardless of the plan committee's good faith or lack thereof.¹⁸⁰

178. *Martinez v. Alto Employees' Trust*, 273 So.2d 735 (La. Ct. App. 1972). The court reasoned that deferring payment because of a fear of competitive employment conflicted with the trustee's duty to administer the trust solely in the interest of the beneficiary—a statutory obligation in Louisiana, but equally the rule under common law. *See Blankenship v. Boyle*, 329 F. Supp. 1089 (D.D.C. 1971). Subsequently, the Louisiana courts held that a fiduciary, in exercising its discretion to make a lump-sum or deferred payment, must examine the financial picture of the participant and make its decision based upon whether the participant's best interests would be served by an immediate or deferred payment. *Deichman v. Alto Employees' Trust*, 332 So.2d 582, 587 (La. Ct. App. 1976). *But see Joy Mfg. Co. v. Stohl*, 137 Ga. App. 109, 222 S.E.2d 888 (1975) (misapplying Pennsylvania law as to right of employer to change inchoate retirement benefits).

179. 434 F. Supp. 671, 673 (S.D.N.Y. 1976) (footnote omitted).

180. *Id.* at 673 n.2. One court has described the common plan pattern of employing major officer-shareholders to administer the plan trust as having "the appearance of a cozy arrange-

A dissenting opinion by Justice Williams¹⁸¹ from the recent Michigan Supreme Court decision in *Woodward v. Cadillac Overall Supply Co.*¹⁸² adopts an approach virtually identical to that in *Amory*, and provides some insight into the rationales behind it. Justice Williams carefully reviewed the judicial treatment of noncompetition forfeiture clauses in other jurisdictions and concluded that Michigan courts should subject those clauses to "strict scrutiny," *i.e.*, both the language of the clause and the application of the restraint should be reasonable.¹⁸³ Moreover, the employer would have the burden of showing that the restraint is valid under the traditional reasonableness test.¹⁸⁴ That burden would be carried only by proof that a noncompetition clause: (1) extends no greater than is necessary for the protection of the legitimate interest of the employer; (2) does not impose undue hardship on the employee; and (3) is not injurious to the interest of the public.¹⁸⁵

Justice Williams justified his "strict scrutiny"—an equivalent to the presumption of unreasonableness in *Amory*—on the grounds that: (1) employer overreaching is invited during the establishment of most retirement plans because of an imbalance in bargaining

ment." *Miller v. Associated Pension Trusts, Inc.*, 541 F.2d 726, 729 (8th Cir. 1976).

181. 396 Mich. 379, 384, 240 N.W.2d 710, 711 (1976). Justice Williams was joined in his dissent by Chief Justice Kavanagh.

182. 396 Mich. 379, 240 N.W.2d 710 (1976). The *Woodward* litigation resulted from the Cadillac Overall's plan committee's termination of the otherwise 100% vested pension rights of certain employees. After a class action suit was filed, the defendants argued their action was justified by the plan's anticompetition bad boy clause. Plaintiffs' motion for summary judgment, based upon a statute prohibiting covenants not to compete, MICH. COMP. LAWS ANN. § 445.761 (1965), was denied by the trial court. The Michigan Supreme Court's affirmation of that denial and remand of the case was based solely on a prior narrow judicial interpretation given the statute, analogous to the employer's choice rationale. The majority opinion, however, closed with the caveat: "Appellant's other arguments are not properly presented for our consideration by this motion for summary judgment but depend upon facts which must be developed at trial." *Id.* at 384, 240 N.W.2d at 711.

This was a case of first impression in Michigan. Six months earlier, the Sixth Circuit had "applied" Michigan law, concluding that Michigan courts would not adopt the "employee's choice" rationale and consequently, would not find an unlimited bad boy clause unreasonable. *Bannert v. American Can Co.*, 525 F.2d 104, 110 (6th Cir. 1975). However, since only a distinct minority of the states have addressed the issue of bad boy clauses in retirement plans, and since there are two conflicting lines of authority in the area, it is risky for federal courts to guess what a state court would hold in a case of first impression. This is another justification for creation of ERISA common law which would govern both during and after the interim period.

183. 396 Mich. at 402, 240 N.W.2d at 715 (Williams, J., dissenting).

184. *Id.* at 403, 240 N.W.2d at 715. The dissent pointed out that "[p]lacing the burden on the employer is sensible not only due to the strict scrutinizing given employee restraints, but also because the employer has a more complete view of the interests of the business than an employee, and thus is in a better position to show a restraint is no more burdensome than needed to protect the employer's legitimate interest." *Id.* at 402 n.17, 240 N.W.2d at 720 n.17.

185. 396 Mich. at 402, 240 N.W.2d at 715.

power; (2) a forfeiture clause is not necessary since the employer already obtains consideration from the employee in the form of his continued services; and (3) noncompetition forfeiture clauses usually affect a far wider range of people than do covenants not to compete ancillary to the sale of a business. In this context, it was noted that ERISA establishes a federal policy regarding noncompetition forfeiture clauses:

The central thrust of the new act is to encourage the creation of private retirement plans through tax incentives and to protect the employee's rights under these plans. Under the act, benefits must vest within certain prescribed time limitations . . . Once the right to benefits vests, it cannot be forfeited with certain exceptions not applicable to this case. Specifically, Congress provided that under the act, a vested right is not to be forfeited because the employee later went to work for a competitor.¹⁸⁶

It would appear that under *Amory* a noncompetition forfeiture clause which is unreasonable in its language, albeit reasonable in application, will not be enforced. Justice Williams' dissent in *Woodward* pointed out: (1) an unreasonably broad noncompetition forfeiture clause has an *in terrorem* effect upon employees who comply with the overbroad restraint; (2) many employees whose benefits are forfeited upon an unreasonable application of such a clause never reach the courts; (3) "an overbroad clause heightens the ill-effect of non-competition forfeiture clauses on the public interest determining competition and employee mobility even where it serves no legitimate interest of the employer;"¹⁸⁷ and (4) enforce-

186. *Id.* at 403, 240 N.W.2d at 716-17 (citations and footnotes omitted). The South Carolina Supreme Court similarly found the ERISA legislative history of great assistance in reaching its conclusion that a bad boy clause is unenforceable, absent reasonable temporal and geographic limitations. *Almers v. South Carolina National Bank*, 217 S.E.2d 135, 139 (S.C. 1975).

187. 396 Mich. at 404, 240 N.W.2d at 719. Justice Williams contrasted a bad boy forfeiture clause in a retirement plan with a covenant not to compete ancillary to sale of a business: a non-competition forfeiture clause is not necessary for the employer to get the major value of what he pays for in entering into an employment contract and establishing a retirement program, *i.e.*, the continued services of his employees and the tax benefits granted businesses establishing retirement programs. Refusal to enforce an overbroad non-competition forfeiture clause does not, therefore, grossly distort the overall agreement between employer and employees.

Id. at 404, 240 N.W.2d at 720.

In contrast, the employee's choice cases, in upholding bad boy clauses, reasoned that these forfeiture provisions were supported by reasonable business justifications that clearly outweighed any potential harm to the competing former employee. "It was designed to protect Graphic Systems and its employees from competition by former employees who attempt at the same time to share the benefits of profits earned by faithful employees whom the plan seeks to reward for their services." *Keller v. Graphic Systems, Inc.*, 422 F.Supp. 1005, 1012 (N. D. Ohio 1976); *accord*, *Golden v. Kentile Floors, Inc.*, 512 F.2d 838, 846 (5th Cir. 1975);

ment of such a clause encourages employers to continue to use overbroad language to the detriment of the public interest.¹⁸⁸ These consequences are important reasons for a court's refusal to enforce an unreasonably worded forfeiture clause.

Federal common law derived from ERISA and its underlying public policy should govern the validity of bad boy clauses during the interim period. However, state law, to the extent it accords with and furthers ERISA objectives, may be incorporated into federal common law. Thus, it must be determined to what degree the state doctrine of "reasonableness" is consistent with ERISA policy.

The *Amory* court, by adopting a reasonableness test similar to that used by the various states, indicated its belief that this standard is consonant with ERISA. Insofar as application of the test results in decreased forfeitures of vested benefits, it is indeed consistent with federal policy. Nevertheless, a reasonableness standard would still allow forfeitures of vested benefits if the bad boy clause was reasonably worded and applied. A question therefore remains whether the reasonableness approach truly furthers the ERISA policy against forfeiture of vested benefits. In short, does ERISA policy require prohibition of all bad boy clauses? If so, does this prohibition extend to bad boy forfeitures of rights vested in excess of ERISA's minimum standards?

Case analysis of the legislative policy underlying ERISA supports a total ban of bad boy forfeitures during the interim period. For example, in *Almers v. South Carolina National Bank of Charleston*,¹⁸⁹ the South Carolina Supreme Court considered a forfeiture clause in a pre-ERISA profit-sharing plan which provided that a participant would lose his vested benefits upon accepting employment with a competitor. While ultimately ruling that forfeiture clauses without reasonable temporal and geographic limitations are invalid, the *Almers* court analyzed Congress' approach in enacting ERISA. The court observed that Congress had concluded that forfeitability of pension and profit sharing retirement income interfered with the mobility of labor to the detriment of the economy. Therefore, under ERISA a vested benefit would no longer be

Miller v. Associated Pension Trusts, 396 F. Supp. 907, 911 (E.D. Mo. 1975), *aff'd*, 541 F.2d 727 (8th Cir. 1976). ("Such a provision is designed to protect the integrity of the plan, and is therefore valid since any competitive actions on the part of a former employee would in all probability have a detrimental effect upon the profit sharing aspect of the plan.")

188. The *Woodward* dissent concluded that an overbroad forfeiture clause, *i.e.*, without temporal or geographic restrictions, either unnegotiated or negotiated when the employee was substantially disadvantaged in bargaining power will always be unreasonable, since an overbroad provision is "contrary to the public interest." 396 Mich. at 403, 240 N.W.2d at 721.

189. 217 S.E.2d 135 (S.C. 1975).

forfeitable merely because the employee later went to work for a competitor or was disloyal to the employer. "Congress noted that it was in the public interest to have a portable working class, unimpeded by forfeiting provisions. Congress has concluded, and we think properly so, that the spectre of financial prostration upon retirement due to forfeitable rights effectively deters employees from accepting competitive employment."¹⁹⁰ The court noted that from this premise, it would follow that forfeiture provisions should always be declared void.

Furthermore, state and federal courts which have analyzed the ERISA minimum vesting provisions have concluded that bad boy forfeiture clauses will be void after the effective date of those provisions.¹⁹¹ Thus, there is no logical reason why bad boy clauses should not be voided as well during the interim period after state law is preempted. This result would not be contrary to the congressional purpose behind the delay in the effective date of the nonforfeitability provisions. As noted earlier, the purpose of the delay is to grant employers adequate time to obtain insurance of their funds to comply with the vesting standards.¹⁹² Voiding anticompetition clauses should not increase costs for either defined benefit or defined contribution plans, since it is unlikely that plan actuaries include amounts due to bad boy forfeitures when calculating plan sponsor contributions.¹⁹³

It would also be consistent with ERISA policy to void bad boy forfeitures of benefits vested in excess of the minimum. However, these forfeitures are allowed under the Treasury's interpretation of the literal language of the statute. Because it can be expected that

190. *Id.* at 139 (citations omitted).

191. See *Keller v. Graphic Systems, Inc.*, 422 F. Supp. 1005, 1008 (N.D. Ohio 1976); *Amory v. Boyden Associates, Inc.*, 434 F. Supp. 671 (S.D.N.Y. 1976); *Woodward v. Cadillac Overall Supply Co.*, 396 Mich. 379, 240 N.W.2d 710 (1976); *Almers v. South Carolina Nat'l Bank*, 217 S.E.2d 135 (S.C. 1975).

192. See text accompanying note 39 *supra*.

193. The plan actuary generally employs "actuarial assumptions" to discount in advance, from the employer contributions needed to provide a participant's benefit at normal retirement age, some or all of the following factors: (1) preretirement mortality; (2) investment experience or "interest"; (3) expense of administration, if not paid by plan sponsor; (4) turnover of employees, *i.e.*, separation from service prior to full vesting or prior to full accrual of the maximum benefit under the plan; and (5) projected changes in compensation. Lee, *Joint and Survivor Annuities under ERISA—The Gamble on Survival*, 3 J. CORP. TAX. 241, 244 n. 8 (1976). The author understands that actuaries generally do not discount in advance for divestitures due to violation of bad boy clauses. Hence a ban on bad boy clauses would not give rise to an "experience loss" which occurs when the fund's actual experience is less favorable than had been anticipated or "assumed" by the actuary. Potentially, both changes in actuarial assumptions and experience loss can increase employer costs without resulting in increased benefit levels.

smaller plans will commonly provide for greater vested benefits than ERISA requires,¹⁹⁴ it can also be expected that a great deal of litigation involving bad boy forfeitures of the excess benefits will arise. Thus, a desirable legislative resolution would be to clearly articulate the policy concerning excess benefit forfeitures.

CONCLUSION

With the advent of ERISA, litigation over the enforceability of bad boy clauses—in recent years the most frequent pension issue in state courts—will shift to the federal courts. The contradiction of ERISA legislative history on its face prohibiting bad boy clauses and Treasury approval of these clauses in restricted though not infrequent circumstances, in addition to increased awareness by retirement plan participants of their ERISA rights,¹⁹⁵ should spur a wave of litigation in this area, already foreshadowed by *Keller* and *Amory*. If the courts do not adopt the suggested approach of invalidating all bad boy clauses after January 1, 1975, as contrary to federal public policy, they are likely to become caught up in the never ending task of determining whether such a clause and its application are reasonable. Moreover, in that event, overly broad bad boy clauses would continue to have their *in terrorem* effect while aggrieved participants would be precluded from coming into court, or from obtaining adequate representation once in court, due to the small dollar amount of their claims. For these reasons, the Department of Labor should shut the post-ERISA Pandora's box opened by the Treasury by strongly and promptly articulating the public policy considerations militating against any enforcement of bad boy clauses.

194. Many existing smaller plans will, in order to meet the requirements of Rev. Proc. 75-49, 1975-1 C.B. 584, as modified by Rev. Proc. 76-11, 1976-1 C.B. 550, either maintain their existing pre-ERISA vesting schedule, which is usually more rapid than the ERISA minimums, see *Credited Service*, *supra* note 44, at 369-70, or grant the greater of the existing schedule or the four-forty rule to existing participants while using the four-forty rule alone for future participants. In both instances, limitation of the bad boy clause to members of the prohibited group will eliminate § 401 (a) (4) discrimination in operation problems. Thus, vested rights in excess of the ERISA minimum standards will undoubtedly exist in a large number of plans for a period after the 1976 calendar year. It should be noted that more than two-thirds of the 473,272 private pensions plans in 1975 had 10 or less participants. However, 90% of all participants were covered by fairly large plans. Department of Labor News Release 76-1403 (Nov. 12, 1976).

195. Department of Labor regulations require that the summary plan description, which must be given to plan participants, contain a statement of the participants' "ERISA rights." Lab. Reg. § 2520.102-3 (t), 42 Fed. Reg. 37,182 (July 19, 1977).

