South Carolina Law Review

Volume 43
Issue 1 *ANNUAL SURVEY OF SOUTH CAROLINA LAW*

Article 10

Fall 1991

Employment Law

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Recommended Citation
(1991) "Employment Law," *South Carolina Law Review*: Vol. 43 : Iss. 1 , Article 10.
Available at: https://scholarcommons.sc.edu/sclr/vol43/iss1/10

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EMPLOYMENT LAW

I. ERISA PRE-EMPTS STATE COMMON-LAW CLAIMS ARISING OUT OF THE ADMINISTRATION OF EMPLOYEE BENEFIT PLANS

In *Baker Hospital v. Isaac*[1] the South Carolina Supreme Court joined the majority of other jurisdictions by holding that the Employee Retirement Income Security Act of 1974 (ERISA)[2] pre-empts state common-law claims arising out of the administration of employee benefit plans.[3]

Baker Hospital (the Hospital) treated Joan Isaac, an employee of Garden Art Landscaping, Inc. (Garden Art), for cocaine addiction. The Hospital performed the treatment only after both Isaac and a representative of the Guardian Life Insurance Company (Guardian) allegedly assured the Hospital that Garden Art's employee benefit plan covered Isaac. The Hospital was not paid for its service and sued Isaac, Garden Art, and Guardian to recover the payment. The suit asserted four common-law causes of action: breach of contract, promissory estoppel, negligence, and misrepresentation. The Hospital sought punitive damages on the misrepresentation claim.[4]

Immediately before the trial, Guardian moved to dismiss the suit for lack of subject matter jurisdiction on the theory that ERISA pre-empted the common-law causes of action. The trial court denied the motion and Guardian appealed.[5]

The Hospital and Guardian stipulated that ERISA pre-empts the common-law claims. The court agreed that *Pilot Life Insurance Co. v. Dedeaux*[6] and "the clear majority rule in other jurisdictions on this issue" establish that ERISA pre-empts the Hospital's common-law claims.[7] The court cited *Dedeaux* for the proposition that ERISA pre-empts any state law that relates to employee benefit plans[8] and that the pre-emptive effect of ERISA is "deliberately expansive."[9] The

1. 301 S.C. 248, 391 S.E.2d 549 (1990).
2. 29 U.S.C. §§ 1001-1461 (1988 & Supp. I 1989), *as amended by* Pub. L. No. 101-508, 104 Stat. 1388 (1990).
3. *Baker Hospital*, 301 S.C. at 250, 391 S.E.2d at 550-51.
4. *Id.* at 249, 391 S.E.2d at 550.
5. *Id.*
6. 481 U.S. 41 (1987).
7. *Baker Hospital*, 301 S.C. at 250, 391 S.E.2d at 550-51.
8. *Id.*, 391 S.E.2d at 500 (citing *Dedeaux*, 481 U.S. at 45).
9. *Id.*, 391 S.E.2d at 551 (citing *Dedeaux*, 481 U.S. at 46).

court noted that *Dedeaux* specifically pre-empted causes of action for breach of contract and bad faith failure to pay an insurance claim.[10] The court also cited authority for the proposition that ERISA pre-empts misrepresentation and negligence causes of action.[11]

On its face, the pre-emptive effect of ERISA is very broad. ERISA states that its "provisions . . . shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan."[12] ERISA defines "State law" as "all laws, decisions, rules, regulations, or other State action having the effect of law, of any State."[13]

A dispute regarding the limit of ERISA pre-emption generally occurs because of the inclusion of a saving clause in the code. The saving clause states that "nothing in this subchapter shall be construed to exempt or relieve any person from any law of any State which regulates insurance, banking, or securities."[14]

Therefore, when a court addresses an ERISA pre-emption problem, the first question is whether the state law "relates to" an employee benefit plan. The second question is whether the law is saved by virtue of being a regulation of insurance, banking, or securities.[15]

In addressing the impact of ERISA pre-emption, courts have considered questions such as the limit of the pre-emption, the plaintiff's right to a jury trial, and the availability of extracontractual or punitive damages. Since *Dedeaux*, courts consistently have found that common-law claims are pre-empted if they arise out of a failure to pay claims under an existing plan.[16] Most courts have found that a right to a jury

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10. *Id.*

11. *Id.* (citing Kuntz v. Reese, 760 F.2d 926 (9th Cir. 1985), *withdrawn and vacated on other grounds*, 785 F.2d 1410 (9th Cir.), *cert. denied*, 479 U.S. 916 (1986); Board of Trustees v. Continental Assurance Co., 690 F. Supp. 792 (W.D. Ark. 1988)). Because the pre-emption issue involved the circuit court's subject matter jurisdiction, the supreme court also rejected the Hospital's assertion that Guardian failed to raise the pre-emption issue in a timely manner. *Id.* at 250-51, 391 S.E.2d at 551 (citing Providence Hosp. v. National Labor Union Health & Welfare Fund, 162 Mich. App. 191, 412 N.W.2d 690 (Ct. App. 1987)).

12. 29 U.S.C. § 1144(a) (1988).

13. *Id.* § 1144(c)(1).

14. *Id.* § 1144(b)(2)(A).

15. *See generally* Annotation, *Construction and Application of Pre-emption Exemption, Under Employee Retirement Income Security Act (29 USCS §§ 1001 et seq.), for State Laws Regulating Insurance, Banking, or Securities (29 USCS § 1144(b)(2))*, 87 A.L.R. FED. 797 (1988) (providing an overview of pre-emption and pre-emption exemption).

16. *See, e.g.*, Amos v. Blue Cross-Blue Shield, 868 F.2d 430, 431 (11th Cir.) (per curiam) (finding that common-law causes of action for fraud and bad faith failure to pay a claim arising out of an alleged wrongful denial of claims under an employee benefit plan were clearly pre-empted by ERISA), *cert. denied*, 110 S. Ct. 158 (1989). In HealthAmerica v. Menton, 551 So. 2d 235 (Ala. 1989), *cert. denied*, 110 S. Ct. 1166

trial does not exist for claims under ERISA because the relief allowed is in the nature of an equitable rather than a legal remedy.[17]

Finally, an award of extracontractual or punitive damages in an ERISA action is unlikely. Plaintiffs often request punitive damages based on the "appropriate relief" language of sections 1132(a)(2)[18] and 1132(a)(3).[19] Section 1132(a)(2) is the enforcement provision for section 1109's liability for breach of fiduciary duty. Section 1132(a)(3) is, however, a general private enforcement provision. In the leading case of *Massachusetts Mutual Life Insurance Co. v. Russell*[20] the United States Supreme Court ruled that extracontractual damages are not available for an individual beneficiary suing under section 1132(a)(2).[21] The Court concluded that nothing in the legislative history supported the availability of extracontractual damages;[22] therefore, it was "reluctant to tamper with an enforcement scheme crafted with such evident care."[23] The Court expressly limited its holding to section 1132(a)(2) and declined to address the availability of extracontractual or punitive damages under any other provision of ERISA, including section 1132(a)(3).[24]

Aplying the logic of *Russell*, a majority of the circuit courts of appeals have held that section 1132(a)(3) also does not authorize extracontractual or punitive damages.[25] In *Powell v. Chesapeake & Poto-*

(1990), the Alabama Supreme Court distinguished *Dedeaux* and held that fraudulent inducement claims arising before an employee actually becomes covered by a plan are not pre-empted. *Id.* at 239-40. The majority and dissenting opinions in this case provide a fairly comprehensive survey of the scope of ERISA pre-emption.

17. *See, e.g.*, Blake v. Unionmutual Stock Life Ins. Co., 906 F.2d 1525, 1526 (11th Cir. 1990) (per curiam) (following "overwhelming precedent" that the Seventh Amendment provides no right to jury trial for claims brought under ERISA).

18. 29 U.S.C. § 1132(a)(2) (1988).

19. *Id.* § 1132(a)(3).

20. 473 U.S. 134 (1985).

21. The Court apparently intended that its holding also should apply to punitive damages. *Id.* at 136, 138, 144 n.12; *see also* Pilot Life Ins. Co. v. Dedeaux, 481 U.S. 41, 53-54 (1987) (stating that *Russell* held that section 1132(a)(2) "provide[s] no express authority for an award of punitive damages"). The Court did not decide whether section 1109, the breach of fiduciary duty section, authorizes a plan, rather than an individual, to recover extracontractual or punitive damages. *Russell*, 473 U.S. at 144 n.12; *cf.* Sommers Drug Stores Co. Employee Profit Sharing Trust v. Corrigan Enters., 793 F.2d 1456, 1463 (5th Cir. 1986) (punitive damages not recoverable by a plan), *cert. denied*, 479 U.S. 1089 (1987).

22. *Russell*, 473 U.S. at 145-47.

23. *Id.* at 147.

24. *Id.* at 139 n.5.

25. Drinkwater v. Metropolitan Life Ins. Co., 846 F.2d 821, 824-25 (1st Cir.), *cert. denied*, 488 U.S. 909 (1988); Bishop v. Osborn Transp., Inc., 838 F.2d 1173, 1174 (11th Cir. 1988); Varhola v. Doe, 820 F.2d 809, 817 (6th Cir. 1987); Kleinhans v. Lisle Sav. Profit Sharing Trust, 810 F.2d 618, 627 (7th Cir. 1987); Sokol v. Bernstein, 803 F.2d 532,

mac Telephone Co.[26] the Fourth Circuit Court of Appeals found that extracontractual and punitive damages are not available under the general private enforcement provision of section 1132(a)(3). Noting that strong support exists for the proposition "that Congress intended to import into ERISA principles of trust law,"[27] the *Powell* court stated that extracontractual and punitive damages are "generally not available in an action by a beneficiary against a trustee for breach of trust."[28]

In *Baker Hospital* the South Carolina Supreme Court held that ERISA pre-empts common-law claims arising under employee benefit plans. This pre-emption probably precludes trial by jury and disallows any extracontractual or punitive damages. The unavailability of extracontractual or punitive damages may remove a traditional incentive for fiduciaries to conform their actions to the high standards required of them. Whether this removal has the effect of lowering the quality of service owed to participants and beneficiaries of ERISA benefit plans is uncertain.

David W. Plowden

II. Supreme Court Discusses Damages for Breach of Contract Based on Employee Handbook

In *Small v. Springs Industries*[29] (*Small II*) the South Carolina Supreme Court addressed damages arising from the wrongful discharge of an employee whose at-will employment contract was modified by an employee handbook. The court previously decided in *Small v. Springs Industries*[30] (*Small I*) that an employee handbook issued by an employer may alter an otherwise at-will employment relationship and that a jury may consider the handbook as evidence of the modification.[31] The *Small II* court held that wrongfully discharged employees may refuse an offer of re-employment without suffering diminution of

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538 (9th Cir. 1986); *Corrigan Enterprises*, 793 F.2d at 1464-65; Powell v. Chesapeake & Potomac Tel. Co., 780 F.2d 419, 424 (4th Cir. 1985), *cert. denied*, 476 U.S. 1170 (1986).

26. 780 F.2d 419 (4th Cir. 1985), *cert. denied*, 476 U.S. 1170 (1986).

27. *Id.* at 424 (citations omitted).

28. *Id.* (citations omitted). The court's reliance on trust law is appropriate. *See Russell*, 473 U.S. at 152 (Brennan, J., concurring).

29. 300 S.C. 481, 388 S.E.2d 808 (1990).

30. 292 S.C. 481, 357 S.E.2d 452 (1987).

31. *Id.* at 485-86, 357 S.E.2d at 455. For a discussion of *Small I*, see *Annual Survey of South Carolina Law, Implied Contract Exception to Employment At Will Doctrine Recognized*, 40 S.C.L. Rev. 157 (1988).

damages if their refusals are reasonable.[32] The court also held that wrongfully discharged employees that sue for breach of contract may receive future damages caused by the employer's breach.[33]

Five years after Kathy Small began working for Springs Industries (Springs), Springs distributed an employee handbook to all employees. The handbook provided for a four-step disciplinary procedure for firing employees. Springs failed to follow the termination procedures in discharging Small, and Small brought a breach of contract action. The jury found that the handbook altered Small's at-will employment status, thus creating an employment contract. It also found that Springs breached the contract by failing to follow the termination procedures and that Springs was liable for the damages resulting from the breach. The jury awarded Small three hundred thousand dollars in damages.[34]

In *Small I* the supreme court affirmed the verdict on the issue of Springs's liability for its breach of contract, but reversed the jury's award as excessive and remanded for a new trial on the damages issue.[35] On retrial the jury awarded Small one hundred thousand dollars in damages, and Springs appealed.[36]

After the supreme court decision in *Small I* and prior to the trial in *Small II*, Springs offered to reinstate Small to her previous position, restore her seniority, waive normal pre-employment physical examination requirements, and expunge records of disciplinary actions from her file. Springs did not condition its offer on settlement of the pending litigation between the parties. Small refused the offer.[37]

The *Small II* court first examined the status of the employment-at-will doctrine in South Carolina. At-will employment means that either the employee or the employer can terminate the employment relationship at any time for good reason, bad reason, or no reason at all.[38] Generally, an employer may terminate an employee that is working for an indefinite period without the termination resulting in a cause of action for breach of contract.[39] The court recognized, however, that there are judicial exceptions to the doctrine of employment-at-will in South Carolina.[40]

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32. *Small II*, 300 S.C. at 485-86, 388 S.E.2d at 811.

33. *Id.* at 488, 388 S.E.2d at 812-13.

34. *Small I*, 292 S.C. at 483, 357 S.E.2d at 453.

35. *Id.* at 486-87, 357 S.E.2d at 455.

36. *Small II*, 300 S.C. at 483, 388 S.E.2d at 810.

37. *Id.*

38. *Id.* at 484, 388 S.E.2d at 810 (citing Todd v. South Carolina Farm Bureau Mut. Ins. Co., 276 S.C. 284, 278 S.E.2d 607 (1981)).

39. *Id.* (citing Hudson v. Zenith Engraving Co., 273 S.C. 766, 259 S.E.2d 812 (1979)).

40. *Id.* Legislation has further eroded the employment-at-will doctrine in South Carolina. For example, the state has adopted a remedy for employees discharged in retal-

The *Small II* court looked to traditional contract-law sources to resolve the damages issues. It concluded that "[a] wrongfully discharged employee suing for breach of contract is entitled to receive the amount of the employees' [sic] net losses caused by the employer's breach. . . . Such losses may include back pay as well as future damages."[41]

As in other contract actions, plaintiffs in wrongful discharge cases have a so-called duty to mitigate damages.[42] Terminated employees can recover only for losses that they, in the exercise of due diligence, could not avoid. This doctrine of avoidable consequences requires discharged employees to use reasonable diligence to obtain other suitable employment.[43] Thus, a significant issue in *Small II* was whether a wrongfully discharged employee must accept an offer of re-employment in order to mitigate damages.

Generally, a wrongfully discharged employee must accept a good faith, bona fide offer of re-employment.[44] For an offer of re-employment to be bona fide, it "must reinstate the employee to the same or a substantially similar position at the same pay. The offer must not require the employee to waive his legal right to pursue his cause of action for wrongful discharge."[45] The employer has the burden of proving that the offer is facially bona fide if it defends its liability for damages on the theory that the plaintiff refused a bona fide re-employment offer.[46]

A bona fide re-employment offer does not, however, always limit the employee's damages to the time of the offer.[47] If an employee has reasonable grounds to refuse the offer, "such as where something has occurred to render further association between the parties offensive or

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iation for instituting workers' compensation proceedings, S.C. CODE ANN. § 41-1-80 (Law. Co-op. Supp. 1990), and for compliance with a subpoena, *id.* § 41-1-70.

41. *Small II*, 300 S.C. at 484, 388 S.E.2d at 810 (citing RESTATEMENT (SECOND) OF AGENCY § 455 (1958); 11 S. WILLISTON, A TREATISE ON THE LAWS OF CONTRACTS §§ 1358, 1361 (3d ed. 1968)).

42. Although often referred to as a "duty to mitigate," it is not a duty in the legal sense, nor is it a condition precedent to recovery. Rather, it is an issue that goes to the appropriate measure of damages. 5 A. CORBIN, CORBIN ON CONTRACTS § 1095, at 518 (1964).

43. *Small II*, 300 S.C. at 484, 388 S.E.2d at 810 (citing S. WILLISTON, *supra* note 41, § 1359; 5 A. CORBIN, *supra* note 42, § 1095; RESTATEMENT (SECOND) OF AGENCY § 455 comment d (1958)).

44. *Id.* at 485, 388 S.E.2d at 811 (citing RESTATEMENT (SECOND) OF AGENCY § 455 comment d (1958); S. WILLISTON, *supra* note 41, § 1359)).

45. *Id.* (citing Flickema v. Henry Kraker Co., 252 Mich. 406, 233 N.W. 362 (1930); University of Alaska v. Chauvin, 521 P.2d 1234 (Alaska 1974)).

46. *Id.* (citing Flickema v. Henry Kraker Co., 252 Mich. 406, 233 N.W. 362 (1930)).

47. *Id.*

degrading to the employee or where other circumstances exist which would make such a renewal of services inequitable,"[48] then the employee will not be subject to a diminution of damages.[49]

Because Springs presented sufficient evidence of a facially bona fide re-employment offer, the burden shifted to Small to show either that the offer was not made in good faith or that her refusal of the offer was reasonable.[50] Small testified that when Springs fired her, she pleaded for her job, but was told she would never work for Springs again. She testified that Springs did not care for her and that it made the offer in an attempt to minimize damages even though Springs knew that it was wrong.[51] The court held that Small's testimony was sufficient to raise a question of fact as to whether she reasonably refused Springs's offer of re-employment and whether Springs made the offer in good faith.[52]

In a concurring and dissenting opinion, Acting Associate Justice Littlejohn strongly criticized the majority's finding that Small's testimony raised a jury issue. He believed the trial judge should have held as a matter of law that Springs owed Small no further compensation after she refused the re-employment offer.[53] "[T]he record is devoid of any evidence [that] reinstatement under the terms offered would have been inequitable."[54] Nonetheless, the majority concluded that Small's damages were not limited to the date of Springs's re-employment offer because the jury had found that the circumstances justified Small's rejection of the offer.[55]

Springs also contended that the jury's award was improper because it included damages of a speculative nature. Springs argued the damages were speculative because Small failed to establish how long Springs would have continued to employ her absent the discharge.[56] The court rejected Springs's argument and found that the one hundred thousand dollar award fell "within the range of damage testimony

48. *Id.*

49. *Id.* at 485-86, 388 S.E.2d at 811. Springs argued that employees must either accept the employer's "facially unconditional offer of reemployment . . . or suffer diminution of their damages awards, irrespective of the reasonableness or good faith of the offer." *Id.* at 486, 388 S.E.2d at 811. The court rejected this argument and reasoned that the majority rule, recognized in South Carolina for over 150 years, is the better rule. *Id.* (referring to Saunders v. Anderson, 20 S.C.L. (2 Hill) 486 (1834)).

50. *Id.* at 487, 388 S.E.2d at 812.

51. *Id.* at 487-88, 388 S.E.2d at 812.

52. *Id.* at 488, 388 S.E.2d at 812.

53. *Id.* at 492, 388 S.E.2d at 814 (Littlejohn, Acting A.J., concurring and dissenting).

54. *Id.* at 491, 388 S.E.2d at 814.

55. *Id.* at 488, 388 S.E.2d at 812.

56. *Id.*

presented by Small's experts."[57]

The *Small II* decision could have serious implications for employment relationships in South Carolina. If Small's unsupported testimony was sufficient to warrant a jury trial, it is difficult to imagine a set of circumstances that will not raise a jury issue as to whether the refusal of an offer of re-employment was unreasonable or whether the employer made the offer in bad faith.

Furthermore, the determination of lost earnings seems speculative and conjectural.[58] No adequate mechanism exists to assist a jury in determining that a certain job will be available for a particular employee in the future or that the employee will not work elsewhere after receiving an award for lost future earnings. Allowing unlimited earnings when the contract is for an indefinite period leads to the incongruous result that a wrongfully discharged at-will employee can receive greater damages than a wrongfully discharged employee with a contract of specified duration.

Unfortunately, the *Small II* holding increases the uncertainty and instability of employment relationships already unsettled by the *Small I* holding. Chief Justice Gregory warned of the potential adverse effects of such decisions on South Carolina employers and employees in his dissent to *Small I*: "[T]oday's holding, without promoting job security, tends to stifle quality economic growth and development and hinder expanded job opportunities in this State."[59]

Stephen Coe

57. *Id.*, 388 S.E.2d at 813.

58. *See* Sterling Drug, Inc. v. Oxford, 294 Ark. 239, 251, 743 S.W.2d 380, 386 (1988) ("[I]t is inherently difficult to fix damages for the wrongful discharge of an employee who is employed for an indefinite term."). *But see* Diggs v. Pepsi-Cola Metro. Bottling Co., 861 F.2d 914, 921-24 (6th Cir. 1988) (finding that under Michigan law future damages in wrongful discharge cases are not inherently speculative).

59. *Small I*, 292 S.C. 481, 488, 357 S.E.2d 452, 456 (1987) (Gregory, C.J., dissenting).