Does One Need to Have Substantial Influence to Select a Top Hat?

By Scott E. Galbreath

This article examines the issue of whether the participants in an unfunded deferred compensation plan maintained primarily for a select group of management or highly compensated employees must have substantial influence or bargaining power over the design of the plan for it to be considered a top hat plan exempt from many of ERISA's statutory safeguards and recent cases that have addressed the issue.

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Introduction

To most people today the term "top hat" conjures up images of magicians, circus ringmasters, or even rock guitarist Slash, rather than Rich Uncle Pennybags (a/k/a Mr. Monopoly) or the bankers from Mary Poppins. However, to ERISA professionals "top hat" means something different altogether—a non-qualified plan that is not subject to many of ERISA's rules regarding participation, vesting, funding, and fiduciary duties meant to protect rank-and-file employees.

The term "top hat" does not appear in the statute or legislative history; rather, the statute exempts an unfunded plan "that is maintained primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees." [ERISA §§ 201(2), 301(a)(3), and 401(a)(1)] It is unclear how or why that phrase came to be known as a top hat plan. Likewise, neither ERISA nor Department of Labor (DOL) regulations define the term "select group of management or highly compensated employees." However, the preamble to the Treasury regulations under Section 414(q) of the Internal Revenue Code (Code), that defines highly compensated employee for the purpose of qualified plans, specifically provides that the Treasury and the DOL agree that the meaning of "highly compensated employee" for purposes of Section 414(q) of the Code is not applicable to the determination of the meaning of the same phrase under ERISA. [*See* TD 8173 (Feb. 19, 1988).] The select group of management or highly compensated employees must be determined in the context of the particular facts and circumstances that apply to the employer.

The legislative history on the top hat exemption is rather sparse. [*See, e.g.,* H.R. Rep. No. 93-1280, at 296 (1974); H.R. Rep. No. 93-533, at 4656 (1974) (Conf. Rep.).] In 1990, the DOL set forth its interpretation of the reason for the top hat exemption in DOL Opinion Letter 90-14A (1990 Opinion) [1990 WL 123933 (May 8, 1990)]. It stated:

> It is the view of the Department that in providing relief for top hat plans from the broad remedial provisions of ERISA, Congress recognized that certain individuals, by virtue of their position or compensation level, have the ability to affect or substantially influence, through negotiation or otherwise, the design and operation of their deferred compensation plan, taking into consideration any risks attendant thereto, and, therefore, would not need the substantive rights and protections of Title I [of ERISA].

Over the years there has been litigation over whether a particular plan is, in fact, a top hat plan exempt from much of ERISA. Why? Because if a plan that was designed to be exempt from ERISA's participation, vesting, funding, and fiduciary duty rules turns out to be subject to such rules, it will necessarily fail to meet those requirements. This would generally mean that the participants must vest earlier than provided for under the plan document. Most cases have examined whether the select group is sufficiently select: in number when compared to the rest of the employer's workforce; in compensation when compared to the rest of the employer's workforce; or consisting of sufficiently highly compensated or key management employees.

Recently, some cases have maintained that the plan at issue could not qualify for the top hat exemption because the participants were not a sufficiently select group since they did not have the ability, or bargaining power, to affect or substantially influence the design and operation of the plan. Such cases required the courts to decide whether "substantial influence" or "bargaining power" is a substantive factor for a plan to be a top hat plan. One recent district court case, *Sikora v. UPMC* [No. 2:12-cv-01860 (W.D. Pa. Dec. 22, 2015)], answered that question with a resounding no. The *Sikora* court specifically said that no appellate circuit court has held that "the ability or bargaining power to affect or substantially influence, through negotiation or otherwise, the design and operation of the plan is a required element of a top hat plan." The US Court of Appeals for the Fourth Circuit squandered an excellent opportunity to add some clarity to this area of jurisprudence when the precise issue was before it in *Bond v. Marriott International, Inc.* [No. 15-1199, *unpublished* (4th Cir. Jan. 29, 2016)] However, it decided the case on other grounds in an unpublished opinion. This article will examine these two cases and their effect on the "substantial influence" issue.

Bond v. Marriott International, Inc.

This case involved a plan adopted by Marriott International, Inc. (Marriott) prior to the enactment of ERISA. The plan provided that participants would annually receive deferred stock awards deemed retirement awards that would be paid in 10 installments beginning upon retirement, disability, or reaching age 65. However, these awards were subject to a vesting schedule whereby the awards would vest on a pro-rata basis each year until the participant reached age 65. When first adopted, the plan only had 16 participants; however, the number grew to thousands of employees by the mid-1970s.

After enactment of ERISA, Marriott determined that the plan was an ERISA pension plan but exempt from ERISA's vesting and other requirements because it was a top hat plan. It so notified participants of its position in 1978.

As stated above, in 1990, the DOL issued its 1990 Opinion on top hat status. Shortly thereafter, Marriott amended its plan and stopped issuing annual retirement awards and replaced them with "stock awards" that were payable upon the recipients' termination of employment. However, Marriott restricted the eligibility for these stock awards to employees with the executive manager pay grade or above, resulting in participation dropping from 2,500 to less than 100 in 1990.

The plaintiffs in the case were former employees who participated in the plan both before and after ERISA was enacted and who left employment with Marriott before turning 65. Thus, they never became fully vested in their retirement awards. They sued in a class action suit, maintaining that the plan was not exempt from ERISA as a top hat plan and, therefore, ERISA's vesting requirements applied and they were owed additional benefits. Marriott first moved to dismiss the case based on the statute of limitations expiring. However, the district court held that the statute of limitations never began running because Marriott did not adopt a claims procedure until after the lawsuit was filed, and plaintiffs were never expressly denied benefits nor sufficiently informed that they had been harmed. After discovery ensued, Marriott moved for summary judgment on the basis that ERISA's vesting requirements did not apply to the plan because it was a top hat plan. In a bench decision, the district court agreed and granted the motion. The plaintiffs then appealed to the Fourth Circuit.

DOL Brief

On May 28, 2015, the DOL filed an *amicus curiae* brief with the Fourth Circuit, supporting the plaintiffs, where it criticized the bench opinion from the district court and reiterated its position in the 1990 Opinion [Brief for the Secretary of Labor as Amicus Curiae Supporting Plaintiffs-Appellants (Brief) (May 28, 2015)] The DOL characterized the bench decision as asking whether the plan provided unfunded deferred compensation to a group that is primarily limited to a select group of management or highly compensated employees. While the court recognized that Congress's intent with respect to the top hat exemption was that there was no need to give all of ERISA's protections to employees with sufficient bargaining power to protect themselves, the Court refused to consider whether the employees at issue in the case had sufficient power such that they did not need ERISA's protections. Finally, the DOL stated the Court erroneously relied on the Second Circuit's decision in *Demery v. Extebank Deferred Compensation Plan (B)* [216 F.3d 283 (2d Cir. 2000)], for the proposition that a plan could meet the top hat exemption even if some participants did not meet the select group criteria, provided the plan was principally intended for management and highly compensated employees. The DOL reiterated its position that to be exempt as a top hat plan, the plan must only cover a select group of management or highly compensated employees, because only those employees have sufficient economic bargaining power to obtain contractual rights to non-forfeitable benefits and do not need the protections ERISA provides to other employees. The DOL concluded that Marriott's interpretation of the top hat exemption adopted by the district court's bench decision threatens to leave employees who do not qualify as members of the top hat group without the protections of ERISA simply because the plan's participants are primarily composed of the select group who are capable of protecting their own pension interests.

Fourth Circuit Decision

The plaintiff-employees appealed the district court's decision granting summary judgment to Marriott based on the plan being a top hat plan. Marriott cross-appealed, challenging the court's decision that the plaintiff's claims were not barred by the statute of limitations. The Fourth Circuit held that the claims were indeed time-barred, concluding that the lower court erred in finding that the statute of limitations never began to run because Marriott never denied plaintiffs' claims. [Bond v. Marriott International, Inc., No. 15-1199, *unpublished* (4th Cir. (Jan. 29, 2016)] The court held that while the formal denial rule is generally applied in ERISA cases, in limited circumstances where the rule is impractical to use, the court must determine if an alternative event should have alerted the plaintiff to his entitlement to benefits he did not receive. Under this approach, a clear repudiation of the benefits by the plan fiduciary would suffice to start the statute of limitations. Otherwise, the Court found, cases where there is no formal claim denial could lead to the anomalous result where the statute does not begin to run until the lawsuit is actually filed. The court then found that when Marriott amended the plan after ERISA's enactment and disclosed its position that the plan was a top hat plan, not subject to ERISA's vesting requirements, the plaintiffs knew that their claim for ERISA's vesting requirements was repudiated and the statute had begun to run. Therefore, the plaintiffs' claims were barred.

Having decided the issue on limitations grounds, the Fourth Circuit had no occasion to address the issue of whether the plan was a top hat plan and whether bargaining power was a required element of the exemption.

Sikora v. UPMC

The *Sikora* case is a district court case from the Western District of Pennsylvania, decided in late 2015. [Sikora v. UPMC, No. 2:12-cv-01860 (W.D. Pa. Dec. 22, 2015)] The case involved a nonqualified deferred compensation plan governed under Section 457(f) of the Internal Revenue Code for its tax treatment, because UPMC is a non-profit, tax-exempt medical corporation. The case involved a Vice President of IT Transformation & IT Infrastructure Services, Sikora, who participated in UPMC's Nonqualified Supplemental Benefit Plan (NQSB Plan) from 2007-2011. Sikora voluntarily terminated his employment at UPMC in 2011. After leaving UPMC, Sikora applied for a lump-sum distribution of his account balance under the NQSB Plan. Sometime in 2012, he received a letter from UPMC stating that he had forfeited all rights and benefits under the plan, because he had not entered into a written Post Retirement Plan Service Agreement and that because the NQSB Plan was a top hat plan it was exempt from ERISA's vesting and non-forfeiture requirements. Sikora then sued for his benefit under ERISA. Both parties moved for summary judgment, maintaining that there were no material facts to be decided and they were entitled to judgment as a matter of law.

The Court granted summary judgment in favor of UPMC, finding that the NQSB Plan was a top hat plan even when viewing the evidence in the light most favorable to Sikora. The parties agreed that the NQSB Plan was unfunded. The Court then found that the NQSB Plan was primarily maintained for the purpose of providing deferred compensation to a select group of management and highly compensated employees. The Court also found that whether it measured the percentage of the UPMC workforce covered by the plan as UPMC calculated it or as Sikora maintained it should be calculated, the result was sufficiently small as both resulted in coverage of less than 1 percent. Likewise, the Court found that the participants in the plan were all highly compensated management employees, rejecting Sikora's argument that there were higher paid employees not offered participation as really just an argument that the plan was too selective. The Court found nothing in the law requiring a top hat plan to cover the highest compensated employees.

However, the most interesting part of the decision was the Court's analysis with respect to the issue of bargaining power that was raised by Sikora as a requirement for top hat status. The Court stated that Sikora argued that bargaining power is an element of the top hat exemption. The Court quite forcefully found there is no such element and verbally chastised Sikora for his characterization of the state of the law. First, the Court criticized Sikora's interpretation of the 1990 Opinon as the DOL's pronouncement that top hat plan participants must have the ability or bargaining power to affect or substantially influence the design and operation of the plan. Sikora argued that such pronouncement was entitled to judicial deference and because the participants in the NQSB Plan did not have such bargaining power, it was not a top hat plan. The Court stated that Sikora insisted that the US Court of Appeals for the Third Circuit, which includes Pennsylvania, as well as other Appellate Circuit Courts, have ***uniformly held*** that participants with bargaining power was a required element of top hat plans. [Emphasis added.] The Court stated, "Unfortunately for Sikora, not a single circuit court has held that."

The Court then visited the cases cited by Sikora and distinguished each one of them as not applying bargaining power as an element and/or only citing the 1990 Opinion as the rationale for the existence of the top hat exemption. The Court reasoned that the one case cited by Sikora that came closest to his position was the Second Circuit's, *Demery v. Extebank Deferred Compensation Plan (B).* [216 F.3d 283 (2d Cir. 2000)] In that case, the Second Circuit examined plaintiffs' argument that they lacked sufficient bargaining power, but because the plaintiffs proffered no evidence suggesting their lack of bargaining power was sufficient to raise a question of fact, the court found that the plan was a top hat plan. The *Sikora* court ruled the issue of bargaining power was not central to the Second Circuit's holding.

The court found Sikora's argument that the First Circuit adopted bargaining power as an element of the top hat exemption in *Alexander v. Brigham & Women's Physicians Org.*, [513 F.3d 37 (1st Cir. 2008)], to be the most egregious misstatement of law. Sikora quoted from the First Circuit opinion how the origins of the top hat exemption lie in Congress's insight that high-echelon employees are presumed able to fend for themselves and protect their own pension interests and, therefore, relaxed ERISA's requirements in their regard. However, the district court pointed out, Sikora "conveniently leaves out" the *Alexander* court's statements that it, "declines the appellant's invitation to depart from the plain language of the statute and jerry-build onto it a requirement of individual bargaining power" and "our holding is that there is no requirement of individual bargaining power."

The court then rejected Sikora's argument that *Alexander* only dealt with individual bargaining power and not the bargaining power of the group as a whole and repeated that no federal court has applied bargaining power as an element for top hat status and that it declined to be the first. It then went on to state that it agreed with *Alexander* that the 1990 Opinion is not entitled to deference and that it does not even purport to be what Sikora says it is. In the court's opinion it is merely a description of the purposes the Department thought Congress likely had in mind when creating the exemption. Further, even if the court accepted that the 1990 Opinion adds bargaining power as an element, the highly compensated employees and managers for whom top hat plans exist are presumed to have such bargaining power by virtue of their positions, and any actual lack of bargaining power is irrelevant. Additionally, the 1990 Opinion states that these employees are presumed to be able to affect or substantially influence their deferred compensation plan design through negotiation "or otherwise." Thus, the DOL recognized that top hat plan participants might influence plan design outside of direct negotiation, and the court gave as an example threatening to leave if they were not happy with the plan design as a component of their compensation.

Conclusion

Do participants have to exercise substantial influence over the design of a deferred compensation plan for it to qualify as an exempt top hat plan? Certainly the *Sikora* court believes the answer is no, that the 1990 Opinion only provides the DOL's opinion as to why Congress created the top hat exemption, and that members of the select group of management or highly compensated employees are presumed to have bargaining power. Likewise, if a participant in a purported top hat plan believes he or she should have ERISA protections because he or she was not a member of the select group, such belief should be based on other factors such as compensation and duties rather than the lack of bargaining power to affect the design of the plan. In addition, under *Marriott International*, any participant seeking clarification of the status of the plan should consider the applicable statute of limitations period to begin running from the initial date of participation.

However, litigation is likely to continue until a federal appellate circuit court specifically decides the issue of bargaining power like the *Sikora* district court did. As of this writing, the *Sikora* decision has not been appealed. However, a district court in Houston held in April of last year that a case must proceed to trial because there are genuine issues of material fact as to whether the plan is a top hat plan, and specifically whether participants having "substantial influence" is a required element of being part of the select group. [Tolbert v. RBC Capital Markets Corp., No. H-11-0107, 2015 WL 2138200 (S.D. Tex. April 28, 2015)] The district court so held after the Fifth Circuit had remanded the case back to the district court to determine whether the plan was a top hat plan. [Tolbert v. RBC Capital Markets Corp., 758 F.3d 619 (5th Cir. 2014)] Both parties moved for summary judgment on the top hat issue. The plaintiffs maintained that, based on the 1990 Opinion, substantial influence is an independent factor that the defendants must show the participants have for the plan to be considered a top hat plan. The defendants countered that there is no such element and they are entitled to judgment as a matter of law. The district court found that the Fifth Circuit has not addressed the issue. Therefore, the case will proceed to trial. Maybe, after trial, this case will be appealed and the Fifth Circuit will address the substantial influence issue directly. ■