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The Top-Hat Exemption After *Sikora*

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The Employee Retirement Income Security Act of 1974 (ERISA) has long been a source of complex and often-expensive litigation for employers. However, as the number of actions brought by employees under ERISA have surged, employer-defendants have often relied on the so-called top-hat exemption to dismiss certain claims involving executives. Now, several federal courts of appeals have addressed the disputed contention that the presence of employee bargaining power is required for a plan to fall under the top-hat exemption. In this article, we look at recent appeals court decisions and their effects on this exemption.

A plan "which is unfunded and is maintained by an employer primarily for the purpose of providing deferred compensation for

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a select group of management or highly compensated employees" is exempt from coverage under several substantive ERISA provisions, including participation, vesting, funding, and fiduciary requirements.[1] These plans are commonly referred to as top-hat plans.[2] A finding that an employer's plan does not qualify for the top-hat exemption could cause the plan to become subject to these requirements, exposing the sponsor to a variety of negative outcomes, including claims of fiduciary breach and requiring the sponsor to accelerate vesting of unvested deferred amounts.

FACTORS DETERMINING THE DEFINITION OF A 'SELECT GROUP'

Determining whether an employer plan qualifies as a top-hat plan involves analyzing whether the plan was established for a "select group" of participants.[3] Several circuits have found that this selectivity element requires consideration of both qualitative and quantitative factors.[4] An increasing number of employee-plaintiffs have now asserted that the "qualitative" component of the analysis requires the court to find that participants in the plan possessed sufficient bargaining power to negotiate with the employer over the design and operation of the particular plan. This claim appears to be substantially based on a 1990 Department of Labor (DOL) opinion letter, which states in relevant part:

> 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.[5]

The judicial responses to the employee-plaintiffs' contentions have been mixed. The Second, Sixth, and Ninth Circuits have accepted these arguments, reasoning that a lack of participant bargaining power prevents a plan from fulfilling the selectivity element necessary for exemption from ERISA as a top-hat plan. For example, in *Duggan*, the Ninth Circuit found that the DOL opinion letter had explained that the top-hat exemption was only intended to apply to employees who exercised the type of bargaining power discussed in that letter.[6] The Second and Sixth Circuits similarly read into the top-hat exemption a requirement of participant bargaining power without reference to this language in the DOL opinion letter.[7]

FIRST CIRCUIT REJECTS THE BARGAINING POWER QUALIFICATION

Prior to November 2017, the First Circuit stood in lone contrast to the courts that considered the presence of participant bargaining power when determining if a plan qualified as a top-hat plan. The First Circuit became the first federal appellate court to squarely reject the contention of a participant bargaining power requirement in *Alexander v. Brigham & Women's Physicians Org., Inc*.[8]

In *Alexander*, a former employee and participant in a deferred compensation plan argued that the top-hat provision of ERISA "implicitly requires that every individual in the select group possess bargaining power sufficient to negotiate the terms of the plans."[9] The court first noted that the text of the top-hat exemption "contains no indication that Congress contemplated that courts would consider employees' ability to bargain over the terms of their deferred compensation plans … when measuring the bona fides of a select group[.]"[10] The First Circuit then considered the DOL opinion letter and acknowledged that a number of courts had interpreted the letter to suggest a requirement of beneficiary bargaining power.[11] Nevertheless, the court "decline[d]… to depart from the plain language of the statute and jerry-build onto it a requirement of individual bargaining power[,]" reasoning that the DOL opinion letter spoke only to Congress's rationale for enacting the top-hat exemption.[12] Although the letter was persuasive insofar as it explained that rationale, the court found that the letter alone could not justify the imposition of a substantive, nontextual requirement for compliance with the exemption. The textual requirement that the top-hat provision only be applied "to a 'select group of management or highly compensated employees'" was sufficient, in the court's view, to safeguard Congress's purpose of protecting employee interests.[13] The court also noted that the implementation of employee-appellant's suggested "participant bargaining power" requirement would likely lead to "bizarre consequences"—namely, "that every top-hat plan [could] be rendered incompliant by demonstrating that a single covered employee lacks bargaining power[.]"[14]

THE THIRD CIRCUIT CONCURS

Alexander was the last federal circuit court opinion to rule on a novel suggestion of a "participant bargaining power" requirement for nearly a decade. But in 2017, the Third Circuit joined the First Circuit in rejecting the "participant bargaining power" requirement and holding that this additional finding was unnecessary to conclude that a plan "is maintained…for a select group[.]"[15]

In *Sikora v. UPMC*, former employee Paul F. Sikora appealed a district court holding that he had participated in a top-hat plan.[16] The Third Circuit had previously established that a plan qualifying for the top-hat exemption has three required, statutory elements: (1) the plan must be unfunded; (2) the plan must "exhibit the required purpose"; and (3) the plan must cover a "select group" of employees.[17] Sikora argued that the plan at issue did not cover a "select group" of employees and therefore was not exempt.[18]

The Third Circuit, like many other courts, recognizes both a "quantitative" and "qualitative" component of the "select group" element.[19] The quantitative component requires the plan to "cove[r] relatively few employees" while the qualitative component requires coverage of "a select group of management *or* highly compensated employees[.]"[20] Although the court found that both the quantitative and qualitative components were satisfied, Sikora alleged that the "select group" element of the test was not satisfied "because there [was] no evidence regarding the 'bargaining power' of the Plan participants."[21] Sikora's argument was based solely on the language of the DOL opinion letter.[22] The court acknowledged that three sister circuits had "inquired into participants' bargaining power before determining whether a particular plan qualifies as a top-hat plan" and that one had relied upon the language of the DOL opinion letter in doing so.[23] Nevertheless, the court found the reasoning of the First Circuit in *Alexander* more persuasive.[24]

Like the First Circuit, the *Sikora* court found the DOL opinion letter persuasive on the issue of Congress's intent in enacting the top-hat exemption.[25] The *Sikora* court, however, reasoned that the letter actually weakened the former employee's position rather than strengthening it. In the court's view, the DOL opinion letter did not "suggest that courts inquire into whether a particular participant wielded the requisite level of 'bargaining power[.]'" Rather, the letter "observes that participants in top-hat plans were deemed by Congress to possess bargaining power 'by virtue of their position or compensation level.'"[26]

WHAT THIS MEANS FOR EMPLOYERS?

The Third Circuit's opinion in *Sikora v. UPMC* serves to deepen an already divisive split in ERISA jurisprudence. Also, the differences in statutory construction can have enormous effects for employers—an identical employee benefits plan, covering an identical amount and type of employees, could be subject to the requirements of ERISA if used by an employer in Cincinnati but completely exempt when used by a Philadelphia employer. Further uncertainty exists for employers located in any of the six federal appellate circuits which have not yet

ruled on this issue. Although district courts within the Fourth,[27] Fifth,[28] Seventh,[29] Eighth,[30] and Eleventh[31]Circuits have ruled on whether plan participants must possess sufficient "bargaining power" for the plan to qualify for the top-hat exemption, none of those courts of appeals have definitively resolved this question. No court in the Tenth Circuit has addressed the issue at all.

Although many district courts have read the DOL opinion letter to support the existence of a "participant bargaining power" requirement, the recent opinion in *Sikora* may serve to change the tides. The *Sikora* decision, in addition to adding another voice to the First Circuit's lone dissent against the other three circuits, may have created the beginning of a judicial trend. In addition to being the only two circuits to reject the "participant bargaining power" requirement, the First and Third Circuit opinions are also the two most *recent* federal appellate decisions on the issue. Although several district courts held in favor of the additional requirement prior to the decision in *Sikora*, they—and the circuit courts to which they appeal—may be more hesitant now that the Third Circuit has weighed in. Furthermore, the Third Circuit is the first opinion that has interpreted the DOL opinion letter as rejecting the notion of a "participant bargaining power" requirement. This reasoning may prove effective, as it offers judges the ability to recognize the persuasiveness of the DOL opinion letter while still rejecting the nonstatutory bargaining power argument.

As uncertainty still remains regarding the "participant bargaining power" requirement for top-hat plans, employers should remain mindful of this interpretation and take precautions to ensure qualification for the exemption. As a practical matter, courts may be less likely to second-guess the level of influence exercised by employees who have reached an upper tier of compensation or management within the company. Employers might consider establishing a "bright line test" for participation in plans intended to be top-hat plans. For example, employers might provide that participants must have a certain job title (e.g., senior vice president) or compensation level to participate, rather than providing the company's board with extensive discretion.

NOTES

1. 29 U.S.C. §§ 1101(a), 1051(2), 1081(a)(3).

2. *Sikora v. UPMC*, Case No. 17-1288, *2 (3d Cir. Nov. 24, 2017) (Smith, C.J.).

3. 29 U.S.C. §§ 1101(a), 1051(2) 1081(a)(3).

4. *See Sikora*, *supra* n.2 at *6; *Alexander v. Brigham & Women's Physicians Org., Inc.*, 513 F.3d 37, 46 (1st Cir. 2008); *Bakri v. Venture Mfg. Co.*, 473 F.3d 677, 678 (6th Cir. 2007); *Demery v. Extebank Deferred Comp. Plan (B)*, 216 F.3d 283, 288 (2d Cir. 2000);

Duggan v. Hobbs, 99 F.3d 307, 312 (9th Cir. 1996) ("the 'select group' requirement includes more than a mere statistical analysis").

5. Advisory Opinion 90-14A.

6. *Duggan*, *supra* n.4 at 312–313.

7. *See Bakri*, *supra* n.4 at 680 (finding that the selectivity element was missing in a plan where employees "had no supervisory, policy making, or executive responsibility, and had little ability to negotiate pension, pay or bonus compensation"); *Demery*, *supra* n.4 at 290 (finding a plan qualified for top-hat status where plaintiffs failed to "proffe[r] either direct or circumstantial evidence suggesting an absence of bargaining power sufficient to raise a question of fact on this issue.").

8. *Alexander v. Brigham & Women's Physicians Org., Inc.*, *supra* n.4 at 37.

9. *Id.* at 42.

10. *Id.* at 46–47.

11. *Id.* at 47.

12. *Id.*

13. *Id.*

14. *Id.* at 47–48.

15. 29 U.S.C. §§ 1101(a), 1051(2), 1081(a)(3).

16. *Sikora*, *supra* n.2 at *3–4.

17. *In re New Valley Corp.*, 89 F.3d 143, 148 (3rd Cir. 1996).

18. *Sikora*, *supra* n.2 at *6.

19. *Sikora*, *supra* n.2 at *6 (citing *In re New Valley Corp.*, *supra* n.17 at 148).

20. *Sikora*, *supra* n.2 at *7.

21. *Id.* at *9.

22. *Id.*

23. *Id.*at *10–12.

24. *Id.*

25. *Id.* at *13.

26. *Id.*

27. "Many courts, including a number in this District, have adopted an additional nonstatutory factor that asks whether 'employees participating in the alleged top-hat plans have sufficient influence within the company to negotiate compensation agreements that will protect their interests where ERISA provisions do not apply.'" *In re Alpha Natural Resources, Inc.*, 554 B.R. 787, 796 (E.D. Va. 2016) (quoting *Davis v. Old Dominion Tobacco Co. Inc.*, 755 F.Supp.2d 682, 704 (E.D. Va. 2010)).

28. *Carrabba v. Randalls Food Markets, Inc.*, 38 F.Supp.2d 468 (N.D. Tex. 1999) (holding an employer failed to satisfy the requirements of the top-hat exemption where "[t]he evidence [did] not persuade the court that any significant number of the participants in the [plan] individually had bargaining power").

29. *Fishman v. Zurich American Ins. Co.*, 539 F.Supp.2d 1036, 1041 fn. 3 (N.D. Ill. 2008) (relying on the First Circuit's opinion in *Alexander* to reject plaintiffs' invitation to consider a "participant bargaining power" requirement).

30. "While ERISA provides no bright line test for determining whether a participant qualifies as a member of a 'select group of management or highly compensated employees,' courts examining this issue have considered qualitative and quantitative factors such as…whether the participant had bargaining power over the plan's terms." *Van Gent v. Saint Louis Country Club*, 2013 WL 6198122, *10 (E.D. Mo. Nov. 27, 2013).

31. *In re The Colonial BancGroup, Inc.*, 436 B.R. 695, 708 (M.D. Ala. 2010) (finding the reasoning of the First Circuit in *Alexander* "persuasive").