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TOP-HAT PLANS: APPEALS COURT REJECTS DEPARTMENT OF LABOR STANDARD

by
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In an important decision, a federal appeals court has rejected the suggestion of Department of Labor Advisory Opinion 90-14A that to constitute a top-hat plan each plan participant must possess bargaining power sufficient to influence the terms of the plan. The case is *Alexander v. Brigham and Women's Physicians Organization, Inc.*, 2008 WL 186385, 42 EBC 2554 (1st Cir. 2008).

In *Alexander*, the court considered two unfunded deferred compensation plans for surgeons who were employed by a surgical group and were also on the faculty of the Harvard Medical School. A physician whose employment had been terminated by the surgical group sued for plan benefits, arguing that the plan failed to satisfy ERISA's vesting requirements and that ERISA's fiduciary standards had not been satisfied. Apparently, the plans were created, at least in part, to sidestep an earnings cap imposed on the surgeons by Harvard. In an effort to avoid the effect of that earnings cap, and therefore to enable the surgical group to recruit and retain surgeons who were Harvard faculty members, the surgical group allowed surgeons to accrue deferred compensation benefits.

A surgeon's ability to earn deferred compensation benefits turned on the level of his or her net practice income ("NPI"), that is, the net of payments attributable to the services the surgeon rendered, less the surgical group's cost allocable to those services. In any year in which a surgeon did not have NPI equal to or greater than his or her base salary, the surgeon incurred an obligation to repay the surgical group for the deficit (either out of future NPI or out-of-pocket). In contrast, if a surgeon's NPI exceeded Harvard's earnings cap, the excess (up to 25 percent of the surgeon's salary) would be credited to his or her account in one of the arrangements. If any surplus NPI remained (that is, if the excess of NPI over the salary cap were greater than the amount consigned to the first nonqualified plan), 50 percent of that surplus would be credited to the surgeon's account in the other nonqualified plan and the remainder would be retained by the surgical group. Should a surgeon produce a negative NPI in any year, the per annum deficit would be carried forward and debited against positive balances in the surgeon's nonqualified plan accounts.

As noted earlier, the plaintiff's employment was terminated by the surgical group. The group notified the plaintiff that he was running a cumulative NPI deficit and, therefore, his nonqualified plan accounts would be debited by more than $400,000 to offset that deficit. The surgeon filed suit in response, asserting, among other things, that the arrangements violated ERISA's vesting and fiduciary duty requirements.

"[T]he ERISA vesting and fiduciary rules did not apply, because the arrangement was a top-hat plan."

The First Circuit held that the ERISA vesting and fiduciary rules did not apply, because the arrangement was a top-hat plan. In reaching this conclusion, the court considered whether the plan was maintained for a "select" group of employees. On that issue, the plaintiff argued that the entire cohort of employees to whom the plan was offered – in this case, every full time surgical group surgeon who held a Harvard faculty appointment – comprised the relevant group. The plaintiff said the plan would, by that measure, be maintained for roughly 30 percent of the workforce, which was not a select group. The court rejected this argument, concluding instead that only those employees realistically having the capacity to benefit from a plan should be considered in determining whether the group was select. These were surgeons with NPI exceeding Harvard's earnings cap. Using that measure, one of the nonqualified plans was never maintained for more than 8.7 percent of employees, while the other plan was never maintained for more than 5.8 percent of employees, which made both groups "select."

The court then turned to whether the select group was a group of "highly compensated employees." The court had little difficulty concluding that it was. It said to have a top-hat plan, the employer must be able to show a "substantial disparity between the compensation paid to members of the top-hat group and the compensation paid to all other workers" (citing *Simpson v. Ernst & Young,* 879 F.Supp. 802, 816 (S.D. Ohio 1994)). Over the three years in question, the average income of contributors to the less exclusive of the two plans was roughly $440,000, which was more than five times the average income of the surgical group's employees as a whole. During this same timeframe, the average income of the more exclusive plan's participants was even greater. The court said that although it may be difficult to determine the exact boundaries of what constitutes "high" compensation within the purview of the top-hat provision, the current case was "no way near the gray area." The participants in the plans were highly compensated in both relative and absolute terms.

In what is probably the most significant aspect of the ruling, the court considered the plaintiff's argument that every member of a top-hat group must possess bargaining power sufficient to influence the terms of the plan. The court rejected this argument in clear terms. In doing so, the court noted Department of Labor Advisory Opinion 90-14A, but characterized its "bargaining" language as simply speaking of Congress' rationale for enacting the top-hat provisions, rejecting the possibility that the statute could be interpreted to require each member of a top-hat group to have the bargaining power necessary to influence the terms of the plan. The court noted that parties agreed that the surgeons, <u>as a group</u>, enjoyed bargaining power, and the court therefore was not required to determine whether such group bargaining power is required to have a top-hat group, but noted its "grave doubts" that the statute could be read to impose such a requirement.

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