ERISA ENFORCEMENT OF NONQUALIFIED EXECUTIVE COMPENSATION ARRANGEMENTS*©

Susan Katz Hoffman
Pepper Hamilton LLP
Philadelphia, PA

I. INTRODUCTION

There are two general types of nonqualified executive pension plans. The first ("nonelective retirement plan") is similar to a qualified retirement plan (either defined benefit or defined contribution), except that it covers only a select group of highly compensated employees and is "unfunded." The second ("deferred compensation plan") is similar to a 401(k) salary deferral plan, except that it is "unfunded" and, usually, is also limited to a select group of highly compensated employees.

A nonelective retirement plan that is maintained in conjunction with a qualified retirement plan may provide for benefits under the qualified plan's formula, to the extent they cannot be provided by the qualified plan because of the limitations of §415 of the Code. This plan is called an "excess benefit plan" and it is exempt from ERISA coverage. Therefore, it is a contract subject to state contract law.

Any other nonelective unfunded retirement plan that covers a "select group of highly compensated" employees is known as a "top hat plan", and it is subject to ERISA (but not the Code). Note that if an excess benefit plan is amended to provide benefits that are restricted because of the compensation limitation of §401(a)(17) of the Code, the plan will become a top-hat plan because it is no longer limited to excess benefits.

Other executive compensation arrangements may be subject to ERISA enforcement if they are found to provide welfare benefits of the type covered by ERISA.

Whether the arrangement provides for welfare or retirement benefits, however, the initial inquiry often focuses on whether the arrangement is a "plan". Given the broad scope of ERISA 's definition of a plan, benefit provisions contained in employment agreements or memoranda may become enforceable under ERISA.

II. Is the Plan Subject to ERISA?

A. Advantages and Disadvantages of ERISA coverage

1. An ERISA plan is subject to federal law, limiting damages to benefits due under the plan (no consequential damages, no punitive damages, no jury trial).

2. A non-ERISA plan is subject to state law which may provide for consequential damages, punitive damages, and jury trial.

3. State law may impose personal liability on corporate owners and officers who fail to pay “wages” when due.

4. An ERISA plan is subject to reporting and disclosure rules, and may be subject to vesting and funding rules.

B. The Plan Must Be a Welfare Benefit Plan or a Retirement Plan.

1. Welfare Benefit Plan --

a. Typical executive-type welfare plan is a severance plan.

b. The severance plan can be included in an employment agreement. *Biggers v. Wittek Industries, Inc.*, 4 F.3d 391 (4th Cir. 1993) (agreement to provide one year of severance is subject to ERISA). However, see *Delaye v. Agripac, Inc.*, 39 F.3d 235 (9th Cir. 1994), *cert. denied*, 131 L. Ed. 2d 289, 115 S. Ct. 1402 (1995) (no ERISA plan because there was no discretion in timing, amount or form of monthly severance payments called for under employment agreement).

c. Single lump-sum payment may not be severance plan subject to ERISA unless it creates an administrative scheme. *Fontenot v. NL Industries, Inc.*, 953 F.2d 960 (5th Cir. 1992) (“golden parachute” payment was not ERISA plan); *Kulinski v. Medtronic Bio-Medicus, Inc.*, 21 F.3d 254 (8th Cir. 1994) (same). However, in *Emmenegger v. Bull Moose Tube Co.*, 197 F.3d 929 (8th Cir. 1999), the court, without citing *Kulinski*, held that a one-page severance policy calling for lump sum payment was an ERISA welfare plan because the employer had to determine whether the termination was for cause and whether the individual had provided excellent service.

d. Second Circuit held that a “stay bonus” was not an ERISA severance plan. *James v. Fleet/ Norstar Financial Group, Inc.*, 992 F.2d 463 (2d Cir. 1993). But see, *Wagner v. Continental Bank*, 1991 U.S. Dist. LEXIS 5751 (E.D. Pa. 1991), 1992 U.S. Dist. LEXIS 3086 (E.D. Pa. 1992), *aff'd in part, vacated in part*, 1993 U.S. App. LEXIS 8005 (3d Cir. 1993) (promise to provide severance and enhanced benefits was enforceable under ERISA’s top-hat provisions even though employer did not adopt amendment to plan providing for the benefits).

e. A life or health insurance program covering executives may be an ERISA plan. *Peterson v. American Life & Health Ins. Co.*, 48 F.3d 404 (9th Cir.), *cert. denied*, 516 U.S. 942 (1995) (ERISA health plan exists where partner remained on one policy when all other employees were switched to another). *But see, Fafara v. American States Life Ins. Co.*, 976 F. Supp. 1368 (D. Ore. 1997) (life insurance policy securing corporate loan and covering the owner was not part of an ERISA plan where another group life insurance policy covered all employees.)

f. A settlement agreement or termination agreement calling for continued benefit coverage may not create an ERISA plan separate from the plan being continued. *Graham v. Balcor Co.*, 146 F.3d 1052 (9th Cir. 1998) (settlement agreement); *Angst v. Mack Trucks, Inc.*,

969 F.2d 1530 (3d Cir. 1992) (severance program).

g. A separation agreement that provided severance benefits and other payments in place of an employer's existing severance plan was itself an ERISA covered plan. *Fort v. St. Paul Fire and Marine Ins. Co.*, No. 01-2344 (D. Minn. May 28, 2002).

2. Retirement Plan --

a. Although most "administrative scheme" rulings finding a grant of an ERISA-type benefit *not* to be a "plan" deal with severance arrangements, the court in *Gunter v. Novopharm USA Inc.*, No. 99-C-7496 (N.D. Ill. Feb. 27, 2001) held that an employment agreement calling for 120 months of supplemental retirement benefits plus insurance benefits did not create an ERISA plan, because it did not create an ongoing administrative scheme and calculation of the benefits was a ministerial task.

b. Plan must defer income to termination of employment. *Modzelewski v. Resolution Trust Corp.*, 14 F.3d 1374 (9th Cir. 1994) (portions of executive employment agreement granting 120 monthly payments upon termination or retirement constitute a top-hat ERISA pension plan, where payments were based on age and length of service). *But see*, *Eckardt v. Wiebel Tool Co.*, 965 F. Supp. 357 (E.D.N.Y. 1997) (deferred compensation agreement providing for 10 years of payments upon retirement, with payment based on cash surrender value of life insurance policies, was not an ERISA plan); *Herring v. Oak Park Bank*, 963 F. Supp. 1558 (D. Kan. 1997) (although phantom stock plan deferred income to termination of employment, no administrative scheme was established because calculation of benefits and maintenance of ledger account was mechanical).

c. According to DOL, a fixed-year deferral is not a retirement plan. — phantom stock plans, bonus pools and royalty pools. *Emmenegger v. Bull Moose Tube Co.*, 197 F.3d 929 (8th Cir. 1999) (phantom stock plan was a bonus plan exempt from ERISA, where payments were deferred for a fixed number of years). But see, *Spitz v. Berlin Indus., Inc.*, 1994 US Dist. LEXIS 1576 (N.D. Ill. 1994) (phantom stock plan is an ERISA retirement plan because phantom stock could not be fully redeemed until age 60, death, disability, or termination of employment; partial redemptions over successive five-year periods did not defeat retirement plan conclusion).

d. A split-dollar life insurance program is usually an ERISA welfare plan. *Williams v. Healthalliance Hospitals, Inc.*, 135 F. Supp. 2d 106 (D. Mass. 2001); *First Capital Life Ins. Co. v. AAA Communications*, 906 F. Supp. 1546 (N.D. Ga. 1995) (widow of former employee had no right to proceeds of policy owned by employer, even though change-of-beneficiary designation form had not been properly transmitted to carrier).

e. An unfunded excess benefit plan is a retirement plan, but is exempt from ERISA.

Gamble v. Group Hosp. & Medical Servs., 38 F.3d 126 (4th Cir.

1994). Employer (parent of National Capital Blue Cross) refused to pay benefits under excess benefit plans to former president, upon orders of state and D.C. insurance regulators. Court affirms that the plans are not subject to ERISA, and therefore the insurance commissioners' orders are not preempted.

Farr v. U.S. West, Inc., 815 F. Supp. 1360 (D. Or. 1992), reversed in part on other grounds 58 F.3d 1361 (9th Cir. 1995). An unfunded excess benefit plan may be a separate plan for tax purposes but part of an ERISA plan for enforcement purposes. Where the excess benefit plan was contained in a single article of an otherwise-qualified ERISA plan, the court found ERISA jurisdiction over the excess benefit plan. The aspect of the district court's decision was affirmed by the 9th Circuit, at note 2.

Bartholet v. Reishauer A.G. (Zurich), 953 F.2d 1073 (7th Cir. 1992). Executive argued that employer had agreed to credit prior service under its pension plan and did not do so. Executive argued that if prior service had been included in plan, contributions to fund that service would have exceeded §415 limits, and therefore the promise related to an excess benefit plan and not an ERISA plan. The court rejected that argument, noting that the plan actually established was funded and not an excess benefit plan. Accord, Olander v. Bucyrus-Erie Co., 187 F.3d 599 (7th Cir. 1999).

f. Watch out for excess benefit plans that become top hat plans when they cover the §401(a)(17) limit as well as §415 limits. *Garratt v. Knowles*, 245 F.3d 941 (7th Cir. 2001) (SERP was top-hat plan even though it did not mention §401(a)(17) where result of calculation was to provide benefits based on compensation in excess of §401(a)(17) limit). *But see, Gamble v. Group Hosp., etc., supra* (court did not reach issue where plan was never amended to address §401(a)(17) issue and §415 limit was lower than benefit that would have been limited by §401(a)(17)). *See also, Hampers v. W.R. Grace & Co.*, No. 99-1362 (1st Cir. Jan. 28, 2000) at n. 3 (although the court characterized the plan as an excess benefit plan, all parties conceded that the plan was a top-hat plan subject to ERISA, and the plan appears to have provided excess benefits under both §415 and §401(a)(17)).

III. Unfunded Top-Hat Retirement Plans

A. ERISA Requirements

An unfunded top-hat deferred compensation retirement plan is subject to limited reporting and disclosure requirements under ERISA, but is exempt from all other substantive requirements of ERISA. A top-hat plan does not have to be in writing. *Pane v. RCA Corp.*, 868 F.2d 631, 637 (3d Cir. 1989).