

THE ERISA HOKEY-POKEY: YOU PUT YOUR TOP HAT IN, YOU PUT YOUR TOP HAT OUT

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I. INTRODUCTION

Congress enacted the Employee Retirement Income Security Act of 1974, as amended (ERISA), thirty years ago to protect private sector employee benefit plans. ERISA, with certain exceptions, applies to any employee benefit plan maintained by an employer engaged in commerce. Congress specifically excluded certain executive (non-qualified deferred compensation) pension benefit plans, so-called “top hat plans,” from ERISA’s substantive coverage, yet required these plans to comply with ERISA’s reporting and enforcement requirements. In all of ERISA, top hat plans are unique: they are covered by trust law, while possessing none of the attributes of a trust. Top hat plans sit atop the proverbial fence: they are part-way in ERISA, and part-way out of ERISA. Because of their “square peg in a round hole” fit, courts have struggled with top hat plan benefits disputes.

A particular area of disagreement among the circuits regards the appropriate standard of review of a plan administrator’s decision to deny benefits when that administrator operates under a conflict of interest. This is the case for every top hat administrator because of the mandatory unfunded nature of top hat plans and the administrator’s lack of fiduciary responsibilities to the top hat plan participant.

This note makes three alternative recommendations to enable ERISA to meet its original objectives of protection and uniformity, which are presently lacking for top hat plan participants. First, this note recommends that Congress amend ERISA to exclude top hat plans from ERISA’s reach altogether. Recognizing that this change will be strongly opposed by plan administrators because it will not allow them to continue the unintended protections they presently enjoy under ERISA, an alternative to include top hat plans in ERISA so that they benefit from protections afforded other ERISA pension benefit plans is considered. Last, absent any statutory changes to ERISA, the courts should review all top hat claim denials *de novo* given top hat plan administrators’ inherent conflict of interest in deciding claim denials.

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Part II of this note will review Congress's purpose in enacting ERISA and describe the various types and requirements of, and provisions for, pension plans covered by ERISA. Top hat plans and the similar, yet differently-situated excess benefit plans will be described along with the rationale in excluding their plan participants from some (or all) of ERISA's protections.

This section will also describe ERISA benefits denial standards of review, starting with the Supreme Court's *Firestone* pronouncement that an administrator's denial of benefits was to be reviewed *de novo*, unless the plan provided discretionary authority to the administrator, in which case an abuse of discretion standard would apply. A discussion of the type of language that constitutes sufficient plan language conferring discretionary authority to a plan administrator follows. This section concludes with a review of the inconsistencies among the circuits in applying *Firestone's* holding, as well as a discussion of the problem of top hat plan administrators' inherent conflict of interest in administering these plans.

Part III will analyze top hat plans, their unlikely inclusion in ERISA based on trust law, and the resulting consequences to plan participants, along with suggestions to provide a better fit for top hat plans either under contract law, by funding top hat plans, or by simply utilizing a uniform *de novo* standard of judicial review of plan administrators' decisions.

Finally, Part IV will anticipate and discuss some of the consequences of the recommendations and summarize the recommendations contained herein.

II. BACKGROUND

A. Congress's Purpose in Enacting ERISA

The Employee Retirement Income Security Act of 1974 (ERISA) is a federal statute that regulates private sector employee benefit plans.¹ ERISA was designed "to protect the integrity of those plans and the expectations of their participants and beneficiaries."² Congress also intended to create uniformity and minimum standards for administering ERISA plans.³ To accomplish these comprehensive goals, ERISA prescribes a uniform set of requirements for employers who voluntarily provide employee benefit plans.⁴ These requirements cover both pension and welfare plans, funded and unfunded, (tax) qualified and non-qualified plans in varying degrees.⁵

ERISA contains three subchapters. Subchapter I, entitled "Protection of Employee Benefit Rights,"⁶ is divided into Subtitles A and B. Subtitle A contains findings, definitions and the coverage provisions governing the entire

¹ 29 U.S.C. § 1001-1461 (2000).

² *Barrowclough v. Kidder, Peabody & Co.*, 752 F.2d 923, 929 (3d Cir. 1985), *overruled on other grounds by* *Pritzker v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 7 F.3d 110 (3d Cir. 1993).

³ See H.R. 93-533, *reprinted in* 1974 U.S.C.C.A.N. 4639, 4643, 4647, 4650.

⁴ Kathryn J. Kennedy, *Judicial Standard of Review in ERISA Benefit Claim Cases*, 50 AM. U. L. REV. 1083, 1084 (2001).

⁵ See 29 U.S.C. § 1001-1461.

⁶ 29 U.S.C. §§ 1001-1145.

Act,⁷ while Subtitle B contains substantive regulatory provisions as well as specific limitations of coverage.⁸ Subtitle B is comprised of seven distinct parts: Part 1, containing requirements on reporting and disclosure;⁹ Part 2, containing participation, vesting and other substantive standards;¹⁰ Part 3, regarding funding;¹¹ Part 4, regarding fiduciary responsibility;¹² Part 5, regarding administration and enforcement;¹³ Part 6, regarding continuation coverage under group health plans;¹⁴ and Part 7, regarding portability, nondiscrimination, and other rules regarding group health plans.¹⁵

Subchapter I of ERISA generally applies to any type of employee benefit plan, whether welfare plans, pension plans, or both.¹⁶ An employee welfare benefit plan is a plan established or maintained by an employer to provide participants or their beneficiaries certain benefits, such as benefits in the event of death or disability.¹⁷ An employee pension benefit plan is a plan established or maintained by an employer that either: (1) provides retirement income to employees; or (2) results in the deferral of income until the employee's employment is terminated or beyond.¹⁸

Some pension and welfare plans are partially or totally excluded from ERISA's substantive and procedural protections. Top hat plans and excess benefit plans, while similar, are treated differently from each other, and from other fully-covered ERISA benefit plans. A key distinction between top hat plans and other fully covered ERISA plans depends on whether the plan is funded.

B. Funded and Unfunded Benefit Plans

ERISA does not define "funded" to assist in the determination of whether a plan qualifies as a top hat plan. However, case law has established that to be a funded plan under ERISA, the plan assets must be "segregated from the general assets of the employer [such that the assets] are not available to general creditors if the employer becomes insolvent."¹⁹

In a much-quoted ERISA funding case, *Dependahl v. Falstaff Brewing Corp.*, the Eighth Circuit stated: "[f]unding implies the existence of a *res sepa-*

⁷ 29 U.S.C. §§ 1001-1003 (General Provisions).

⁸ 29 U.S.C. §§ 1021-1145 (Regulatory Provisions).

⁹ 29 U.S.C. §§ 1021-1031.

¹⁰ 29 U.S.C. §§ 1051-1061.

¹¹ 29 U.S.C. §§ 1081-1086.

¹² 29 U.S.C. §§ 1101-1114.

¹³ 29 U.S.C. §§ 1131-1147.

¹⁴ 29 U.S.C. §§ 1161-1169.

¹⁵ 29 U.S.C. §§ 1181-1183, 1185-1185b, 1191-1191c.

¹⁶ Susan G. Curtis & Richard G. Schwartz, *ERISA Coverage*, 574 PLI/Tax 577, 579 (2003).

¹⁷ 29 U.S.C. § 1002(1). See also Curtis & Schwartz, *supra* note 16, at 580 (listing benefits as including: "medical, surgical, hospital care or benefits, benefits in the event of sickness, accident, disability, death or unemployment, vacation benefits, apprenticeships and other training programs, day care centers, scholarship funds, prepaid legal services or any benefit contained in § 302(b) of the Labor Management Relations Act of 1947, except for pensions on retirement or death and the insurance to provide for such pensions.").

¹⁸ 29 U.S.C. § 1002(2)(A).

¹⁹ *Northwestern Mut. Life Ins. Co. v. Resolution Trust Corp.*, 848 F. Supp. 1515, 1517 (N.D. Ala. 1994).

rate from the ordinary assets of the corporation.”²⁰ Since *Dependahl*, the existence of a separate *res* or *corpus* has been significant to courts’ determination of funding.²¹ Thus, participants of unfunded plans have no preferred claim or ownership interest in plan assets, because there are no designated plan assets. The rights of an unfunded plan participant are equivalent to those of an unsecured creditor of the employer’s general assets.²²

Additionally, the Department of Labor (DOL) determines whether a plan is funded based on the tax consequences of the employer’s plan arrangement. The DOL considers a plan to be unfunded when plan participants “do not incur tax liability during the year that the contributions to the plan are made.”²³ The tax treatment of pension plans is determined based on whether the plans meet certain Internal Revenue Code (IRC) requirements, resulting in the distinction between “qualified” and “non-qualified” plans.

C. *Qualified and Non-Qualified Pension Plans*

The fundamental goal of either qualified or non-qualified deferred compensation plans is to defer tax liability. Each of these plans accomplishes this goal in very different ways.

A qualified plan meets requirements imposed by the IRC, including minimum coverage and nondiscrimination requirements, and limitations on the amount of benefits that can be provided.²⁴ When a plan complies with these IRC requirements, it “qualifies” for favorable tax treatment, both to the employer and to the employee. The employer is permitted to take a tax deduction for any amounts contributed to the qualified plan, while the employee is not taxed on the benefits until he is actually paid from the plan, usually after retirement when the individual’s tax rate is lower.²⁵

A non-qualified plan can provide benefits in excess of those permitted under the qualified plan limitations.²⁶ Additionally, a non-qualified plan is not required to meet the same minimum coverage and nondiscrimination standards of a qualified plan.²⁷ However, the tax treatment of a non-qualified plan is not as favorable as that of a qualified plan. The employer does not get an immediate tax deduction, but instead can take the deduction at the time the benefits are actually paid to the employee. If the plan is unfunded and unsecured, the employee is not taxed until the time he receives the benefits.²⁸ Significantly, however, the employee loses the security he would otherwise have under ERISA if the plan was a qualified, funded plan.

²⁰ *Dependahl v. Falstaff Brewing Corp.*, 653 F.2d 1208, 1214 (8th Cir. 1981).

²¹ *See Belsky v. First Nat’l Life Ins. Co.*, 818 F.2d 661, 663 (8th Cir. 1987); *Miller v. Heller*, 915 F. Supp. 651, 656 (S.D.N.Y. 1996); *Northwestern Mut. Life Ins. Co.*, 848 F. Supp. at 1518.

²² *Demery v. Extebank Deferred Comp. Plan (B)*, 216 F.3d 283, 287 (2d Cir. 2000).

²³ *Miller*, 915 F. Supp. at 659 (discussing DOL [Department of Labor] Opinion Letters and the DOL’s deference to the Internal Revenue Service in its funding determinations).

²⁴ I.R.C. § 401(a) (2000).

²⁵ I.R.C. §§ 404(a) (1974), 402(a) (2004).

²⁶ 29 U.S.C. § 1002 (2000).

²⁷ *Id.*

²⁸ I.R.C. § 83 (2000); 26 C.F.R. § 1.83-3(e) (2000) (excluding from the definition of property “an unfunded and unsecured promise to pay money in the future”).

D. Fiduciary Responsibilities under ERISA

ERISA defines a fiduciary as a person who exercises any discretionary authority or discretionary control in the management of a plan or exercises any authority or control in the management or disposition of the plan's assets.²⁹ The primary responsibility of a fiduciary is to administer the benefit plan "solely in the interest of participants and beneficiaries and for the exclusive purpose of providing benefits and paying plan expenses."³⁰ Fiduciaries must avoid conflicts of interest, meaning "they may not engage in transactions on behalf of the plan that benefit parties related to the plan," including the plan sponsor.³¹ Fiduciary duties apply to all ERISA covered benefit plans unless a plan is specifically excluded from those duties within the statute. Top hat plan administrators are exempted from any fiduciary duties.³²

E. ERISA's Enforcement Provision

ERISA's enforcement provision, § 502(a)(3), allows a benefit plan participant to obtain "appropriate equitable relief" only to redress violations of ERISA or to enforce the terms of the plan.³³ "ERISA's broad preemption provision makes it clear that Congress intended to establish employee benefit plan regulation as an exclusive federal concern, with federal law to apply exclusively, even where ERISA itself furnishes no answer."³⁴

Thus, ERISA preempts state law causes of action for any benefit plan covered by ERISA.³⁵ Additionally, ERISA precludes any opportunity for a jury trial, and requires a plaintiff to sue the plan itself.³⁶

F. Excess Benefit Plans

An excess benefit plan, under ERISA, is defined as "a plan maintained by an employer solely for the purpose of providing benefits for certain employees in excess of the limitations on contributions and benefits imposed by section 415 of [the Internal Revenue Code of 1986]"³⁷ To be an excess benefit plan, the plan can be either funded or unfunded, but the plan itself must expressly refer to IRC § 415 or to its substantive provisions.³⁸

²⁹ 29 U.S.C. § 1002(21)(A).

³⁰ U.S. Dep't. of Labor, *Fiduciary Responsibilities*, at <http://www.dol.gov/dol/topic/health-plans/fiduciaryresp.htm> (last visited Feb. 1, 2005).

³¹ *Id.*

³² 29 U.S.C. § 1101(a)(1).

³³ 29 U.S.C. § 1132(a); *Barrowclough v. Kidder, Peabody & Co.*, 752 F.2d 923, 935 (3d Cir. 1985) (stating "[t]he plain language of 29 U.S.C. § 1132(a) provides a cause of action either to enforce the substantive provisions of the Act or to recover benefits due or otherwise enforce the terms of a particular plan.").

³⁴ *In re White Farm Equip. Co.*, 788 F.2d 1186, 1191 (6th Cir. 1986) (emphasis added) (citing 120 Cong. Rec. S15751 (daily ed. Aug. 22, 1974) (remarks of Sen. Javits)).

³⁵ 29 U.S.C. § 1144(a).

³⁶ Pamela Baker, *Top Hat Plans Issues and Developments*, SH006 ALI-ABA 489, 538-39 (Oct. 2002).

³⁷ 29 U.S.C. § 1002(36).

³⁸ *Northwestern Mut. Life Ins. Co. v. Resolution Trust Corp.*, 848 F. Supp. 1515, 1519 (N.D. Ala. 1994).

If funded, an excess benefit plan is an ERISA-covered plan.³⁹ However, Congress excluded unfunded excess benefit plans from ERISA, in their entirety.⁴⁰ Because unfunded excess benefit plans are totally exempt from ERISA, they are adjudicated according to contract principles.⁴¹

G. Top Hat Plans

Top hat plans are pension benefit plans that are unfunded and "maintained by an employer primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees."⁴² Top hat plans are implemented to defeat the contribution limits of qualified retirement plans. For instance, while a non-executive employee can expect to receive a retirement income of seventy to seventy-five percent of pre-retirement income from a combination of tax-qualified plans and Social Security, an executive will commonly receive only thirty to thirty-five percent of pre-retirement income from these same benefits.⁴³

Top hat plans are excluded from ERISA's vesting,⁴⁴ funding,⁴⁵ and fiduciary responsibility requirements;⁴⁶ but they are subject to ERISA's reporting and disclosure provisions,⁴⁷ and its administration and enforcement requirements.⁴⁸ Unlike excess benefit plans, top hat plans are limited in both the number and type of participants that can be included in the plan.⁴⁹

In explaining why Congress deliberately chose to exclude executives and highly compensated employees from the substantive protections of ERISA, the Department of Labor stated:

[I]n 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.⁵⁰

ERISA preempts state law causes of action regarding top hat plans.⁵¹ This means that even though a top hat plan is not subject to ERISA's fiduciary rules, state law claims asserting negligence, misrepresentation, or fraud are pre-

³⁹ *Dependahl v. Falstaff Brewing Corp.*, 653 F.2d 1208, 1213-14 (8th Cir. 1981).

⁴⁰ 29 U.S.C. § 1003(b)(5).

⁴¹ *Baker*, *supra* note 36, at 484.

⁴² 29 U.S.C. § 1101(a)(1).

⁴³ Lynn Siewert, *Non Qualified Deferred Compensation*, at <http://401kpsp.com/nqdc.htm> (last visited Feb. 1, 2005).

⁴⁴ 29 U.S.C. § 1051(2) (1979) (excepting top hat plans from ERISA's vesting requirements).

⁴⁵ 29 U.S.C. § 1081(a)(3) (1979) (excepting top hat plans from ERISA's funding requirements).

⁴⁶ 29 U.S.C. § 1101(a)(1) (1999) (excepting top hat plans from ERISA's fiduciary responsibility requirements).

⁴⁷ 29 U.S.C. §§ 1021-1031.

⁴⁸ 29 U.S.C. §§ 1131-1145.

⁴⁹ *Baker*, *supra* note 36, at 494.

⁵⁰ DOL Office of Pension & Welfare Benefit Programs, Opinion 90-14 A, 1990 WL 123933, at *1 (May 8, 1990).

⁵¹ 29 U.S.C. § 1144(a).

empted where the claim "relates to" an ERISA-covered plan.⁵² Additionally, the plaintiff in an ERISA action has no opportunity for a jury trial and must sue the plan itself.⁵³

Because of their unique part-way in, part-way out ERISA coverage, the treatment of top hat plans has perplexed the courts. As will be discussed next, ERISA is based on trust law, yet top hat plan participants benefit from none of those trust-like provisions (i.e., funding, vesting, and the fiduciary responsibilities of administrators) built into ERISA to protect most other plan participants.

H. *The Supreme Court, Firestone, and the Standard of Review*

In *Bruch v. Firestone*,⁵⁴ six Firestone employees filed a class action lawsuit claiming they were due certain severance benefits under an employee welfare benefit plan as a result of Firestone's sale of its Plastics division.⁵⁵ The district court granted Firestone's motion for summary judgment, holding that Firestone's decision not to pay the severance benefits was not arbitrary or capricious.⁵⁶

The Third Circuit reversed the summary judgment, noting that, while most federal courts reviewed benefit denials under the arbitrary and capricious standard, this case involved a conflicted administrator.⁵⁷ The court of appeals then held that, in cases where fiduciaries and administrators had some bias or adverse interest, as when an employer is both the fiduciary and administrator of an unfunded benefit plan, a review of its decision should be made under *de novo* judicial review.⁵⁸

On appeal, the Supreme Court granted certiorari to resolve conflicts among the courts of appeals regarding the appropriate standard of review in ERISA benefits denials challenges.⁵⁹ Although ERISA is a comprehensive piece of legislation, the Court observed that the statute does not provide the appropriate standard of review for challenges to benefit eligibility determinations.⁶⁰

As noted by the U.S. Supreme Court in its *Firestone* decision, "ERISA abounds with the language and terminology of trust law."⁶¹ ERISA's fiduciary responsibility requirements "codif[y] and mak[e] applicable to fiduciaries certain principles developed in the evolution of the law of trusts."⁶² Nodding to

⁵² *Reliable Home Health Care, Inc. v. Union Cent. Ins. Co.*, 295 F.3d 505, 515 (5th Cir. 2002).

⁵³ *Baker*, *supra* note 36, at 538-39.

⁵⁴ *Bruch v. Firestone Tire & Rubber Co.*, 640 F.Supp. 519 (E.D. Pa. 1986), *aff'd in part, rev'd in part*, 828 F.2d 134 (3d Cir. 1987), *aff'd in part, rev'd in part*, 489 U.S. 101 (1989).

⁵⁵ *Id.* at 522.

⁵⁶ *Id.* at 524.

⁵⁷ *Firestone*, 828 F.2d at 138-40.

⁵⁸ *Id.* at 149.

⁵⁹ *Firestone*, 489 U.S. at 108. In her opinion for the unanimous Court, Justice O'Connor explained that ERISA § 1132(a)(1)(B) provides for suits "to recover benefits due under the plan, to enforce rights under the terms of the plan, and to obtain a declaratory judgment of future entitlement to benefits under the provisions of the plan contract." *Id.*

⁶⁰ *Id.* at 109.

⁶¹ *Id.* at 110.

⁶² H.R.REP. NO. 93-533, at 11 (1973).

trust law, the Court stated, "[t]rust principles make a deferential standard of review appropriate when a trustee exercises discretionary powers."⁶³

The Court then clarified that an administrator's "discretionary powers" must come from the trust instrument itself.⁶⁴ Based on that reasoning, and the fact that Firestone's benefit plans did not provide any discretion to the administrator, the Court rejected Firestone's argument that its benefits denial decision should be reviewed under the arbitrary and capricious standard.⁶⁵ Instead, the Court held that "a denial of benefits challenged under § 1132(a)(1)(B) is to be reviewed under a *de novo* standard *unless* the benefit plan gives the administrator or fiduciary discretionary authority to determine eligibility for benefits or to construe the terms of the plan."⁶⁶

The *Firestone* Court stated:

[F]or purposes of actions under § 1132(a)(1)(B), the *de novo* standard of review applies regardless of whether the plan at issue is funded or unfunded and regardless of whether the administrator or fiduciary is operating under a possible or actual conflict of interest. Of course, if a benefit plan gives discretion to an administrator or fiduciary who is operating under a conflict of interest, that conflict must be weighed as a "facto[r]" in determining whether there is an abuse of discretion."⁶⁷

Sadly, this language has resulted in inconsistencies among the courts of appeals regarding the application of appropriate standards of review, particularly in unfunded top hat plans.⁶⁸ In spite of the fact that the Court intended the *de novo* standard be applied to any ERISA plan (unless the administrator was given discretion in the plan document for its decisions) whether the plan was funded or not, the circuit courts have not applied this mandate uniformly.

I. Discretionary Authority

In *Firestone*, the Supreme Court held that a plan administrator's denial of benefits was to be reviewed *de novo*, unless the benefit plan gives the administrator discretionary authority to determine eligibility for benefits or to construe the terms of the plan, in which case it would then be reviewed under the abuse of discretion standard.⁶⁹ Thus, "the default is that the administrator has no discretion, and the administrator has to show that the plan gives it discretionary authority in order to get any judicial deference to its decision."⁷⁰

The circuit courts appear to agree that there are no "magic words" required to determine the scope of judicial review of benefit denial decisions.⁷¹ How-

⁶³ *Firestone*, 489 U.S. at 111.

⁶⁴ *Id.*

⁶⁵ *Id.* at 112-115.

⁶⁶ *Id.* at 115 (emphasis added).

⁶⁷ *Id.*

⁶⁸ Kennedy, *supra* note 4, at 1119-30.

⁶⁹ *Firestone*, 489 U.S. at 115.

⁷⁰ *Kearney v. Standard Ins. Co.*, 175 F.3d 1084, 1089 (9th Cir. 1999) (en banc).

⁷¹ *Block v. Pitney Bowes, Inc.*, 952 F.2d 1450, 1453 (D.C. Cir. 1992) (stating that *Firestone* did not suggest that "discretionary authority hinges on incantation of the word 'discretion' or any other 'magic word.'"); *Kinstler v. First Reliance Standard Life Ins. Co.*, 181 F.3d 243, 251-52 (2d Cir. 1999); *Chevron Chem. Co. v. Oil, Chem. & Atomic Workers Local Union 4-447*, 47 F.3d 139, 142-43 (5th Cir. 1995); *Herzberger v. Standard Ins. Co.*, 205 F.3d 327, 331 (7th Cir. 2000); *Sandy v. Reliance Standard Life Ins. Co.*, 222 F.3d 1202, 1207 (9th Cir.

ever, the courts interpret what constitutes sufficient plan language conferring discretion somewhat differently. Some courts require that the grant of discretion be "clear and unequivocal,"⁷² while others require that the language "expressly confers such authority,"⁷³ and others require the grant of discretionary authority to the administrator to be "clear."⁷⁴ At least one circuit actually has drafted language for employers to include in their ERISA plans to ensure discretionary review.⁷⁵

In spite of this seeming agreement, a plan's language in one circuit could confer discretionary authority while the same or similar language in another circuit might not. In fact, the Ninth Circuit admitted this was the case in *Sandy v. Reliance Standard*,⁷⁶ where the court held that requiring a claimant "to submit 'satisfactory proof' does not unambiguously confer discretion under *Kearney*."⁷⁷ The court acknowledged:

[T]his puts us in the awkward position of construing the effect of identical language in plan documents of the same insurer differently from the Sixth Circuit, which held that the requirement that a claimant submit 'satisfactory proof of Total Disability to us' sufficiently granted discretion to Reliance in *Yeager v. Reliance Standard Life Ins. Co.* However, we are bound by *Kearney*.⁷⁸

There is no doubt many plan administrators amended their plans following the *Firestone* holding to clearly "grant the plan administrator the authority to determine eligibility for benefits and to construe the terms of the plan."⁷⁹ Amending a plan to confer discretionary authority on the plan administrator is an easy way for administrators to evade ERISA's intent of protecting the interests of plan participants in employee benefit plans.⁸⁰

J. Disagreement Among the Courts of Appeals: Conflicted Administrators and Top Hat Plans

In *Firestone*, Justice O'Connor stated that a fiduciary granted discretionary authority operating under a conflict of interest is still entitled to the abuse of discretion standard of review, although the conflict of interest must be considered as one factor in a court's determination of whether the fiduciary abused its

2000) ("For sure, there is no magic to the words 'discretion' or 'authority' – but we're not at Hogwarts.").

⁷² *Heasley v. Belden & Blake Corp.*, 2 F.3d 1249, 1254-58 (3d Cir. 1993); *Sandy*, 222 F.3d at 1207.

⁷³ *Chevron Chem. Co.*, 47 F.3d at 142-43.

⁷⁴ *Perez v. Aetna Life Ins. Co.*, 150 F.3d 550, 555-56 (6th Cir. 1998).

⁷⁵ *Herzberger*, 205 F.3d at 331 (where Chief Judge Posner proposed the language: "[b]enefits under this plan will be paid only if the plan administrator decides in his discretion that the applicant is entitled to them").

⁷⁶ *Sandy*, 222 F.3d. at 1205 n.2.

⁷⁷ *Id.* at 1204 (citing *Kearney v. Standard Ins. Co.*, 175 F.3d 1084 (9th Cir. 1999)).

⁷⁸ *Id.* at 1205 n.2 (citing *Yeager v. Reliance Standard Life Ins. Co.*, 88 F.3d 376 (6th Cir. 1996)).

⁷⁹ Roger C. Siske et al., *What's New in Employee Benefits: A Summary of Current Cases and Other Developments*, SC62 ALI-ABA 1, 105 (1998). See also *Kinstler v. First Reliance Standard Life Ins. Co.*, 181 F.3d 243, 250 (2d Cir. 1999) (recognizing "the relative ease with which ERISA plans may be worded explicitly to reserve to plan administrators the discretionary authority that will insulate all aspects of their decisions from *de novo* review.").

⁸⁰ 29 U.S.C. §1001(a) (2000).

discretion.⁸¹ As noted above, the courts of appeals have implemented the *Firestone* standard of review mandate in many different forms.⁸² A significant area of disagreement among the circuits relates to the standard of review when the administrator or fiduciary has a conflict of interest. "A conflict of interest occurs when the denial [of a benefit claim] has the potential to benefit the one making the decision."⁸³ This conflict is inherent when a plan administrator makes claims determinations that could affect the company's financial interests or profits.⁸⁴

Under trust law, a fiduciary is required to make all decisions in the beneficiary's best interest,⁸⁵ but, with no funding or fiduciary responsibilities required by ERISA, top hat plan administrators are not "fiduciaries" and are not required to make any decisions in the participant's best interest. The difficulty facing the circuits today is the application of *Firestone's* trust-based standard of review to contract-based top hat plans, because *Firestone* was intended to address all benefit plans, funded and unfunded.⁸⁶

Funded benefit plans under ERISA impose fiduciary responsibilities on the administrator. So, even when the employer is both the settlor of the benefit plan and the trustee of the plan assets, fiduciary duties require that he make decisions in the best interest of the plan participants.⁸⁷ Conversely, unfunded pension benefit plans under ERISA are unsecured promises to pay benefits at termination or later.⁸⁸ Essentially, then, unfunded pension plans are paid on an as-needed basis, which results in an inherent conflict between the promisor's role as employer and its role as plan administrator: the decision to pay benefits – or not – will "always directly impact the cost to the employer."⁸⁹

The Ninth Circuit analogizes the inherent conflict of unfunded top hat plan administrators to that of insurance companies acting as plan administrators of unfunded employee welfare benefit plans.⁹⁰ In the welfare benefit situation, other circuits conclude that an insurance company that also acts as the plan administrator making the decision whether to pay a claim from its own assets puts the insurer in a "perpetual conflict with its profit-making role as a business."⁹¹ Still other circuits require that a claimant prove an actual conflict of interest beyond the inherent conflict in order to use a less deferential standard

⁸¹ *Firestone*, 489 U.S. at 115.

⁸² See *supra* notes 71-78 and accompanying text.

⁸³ David Trueman, *Strategies for Challenging Benefit Denials Under ERISA*, <http://truemanlaw.com/newpage33.htm> (Feb. 1999) (last visited Feb. 1, 2005).

⁸⁴ *Id.*

⁸⁵ RESTATEMENT (THIRD) TRUSTS § 2, cmt b. (2003).

⁸⁶ *Firestone*, 489 U.S. at 115.

⁸⁷ Kennedy, *supra* note 4, at 1147.

⁸⁸ 29 U.S.C. § 1002(2)(A) (2000). The unfunded nature of top hat plans requires that payment be made at the employee's termination or later, and that the assets available to the employee under the top hat plan also be available to any creditor of the company – thus the employee is in the same position as any other unsecured creditor to obtain his benefit. *Demery v. Extebank Deferred Comp. Plan (B)*, 216 F.3d 283, 287 (2d Cir. 2000).

⁸⁹ Kennedy, *supra* note 4, at 1147-48.

⁹⁰ *Friedrich v. Intel*, 181 F.3d 1105, 1109-10 (9th Cir. 1999) (holding an employer acting as the administrator of a self-funded plan is inherently self-interested).

⁹¹ *Pinto v. Reliance Standard Life Ins. Co.*, 214 F.3d 377, 384 (3d Cir. 2000) (quoting *Brown v. Blue Cross & Blue Shield of Ala., Inc.*, 898 F.2d 1556, 1561 (11th Cir. 1990)).

of review than the arbitrary and capricious or abuse of discretion standard given to fiduciaries with discretionary authority in *Firestone*.⁹²

There is no current body of law that specifically regards conflict of interest situations involving top hat plans, which are by definition unfunded pension benefit plans. However, in conflict of interest situations involving funded pension benefits plans, or unfunded welfare benefits plans, the courts of appeals have developed three different methodologies for determining the appropriate standard for reviewing the plan administrator's decisionmaking.⁹³ The main difference among these three methodologies hinges on how much discretion a court determines a conflicted fiduciary should receive when the decisions it made could be construed to be in the fiduciary's best interest, rather than in the beneficiary's best interest.⁹⁴

1. *De Novo Standard: Second Circuit*

The Second Circuit uses a two-part test to determine the standard of review once a claimant alleges a conflict of interest in the plan administrator's decision.⁹⁵ First, the court determines whether the administrator's decision was reasonable.⁹⁶ Second, the court determines whether a conflict of interest influenced the administrator.⁹⁷ If a conflict of interest is found, then the court applies the *de novo* standard of review, in place of the abuse of discretion standard normally applicable when a plan administrator reserves for itself discretionary authority to interpret the terms of the plan document.⁹⁸

2. *Sliding Scale or Heightened Arbitrary and Capricious Standard: First, Third, Fourth, Fifth, Sixth, Seventh, Eighth, and Tenth Circuits*

The majority of circuits adjust the arbitrary and capricious standard of review afforded a plan administrator once a conflict of interest is inferred.⁹⁹

⁹² See *Pari-Fasano v. ITT Hartford Life & Acc. Ins. Co.*, 230 F.3d 415, 419 (1st Cir. 2000) (citing *Doyle v. Paul Revere Life Ins. Co.*, 144 F.3d 181, 184 (1st Cir. 1998), where the court stated it would use the arbitrary and capricious standard "with the burden on the claimant to show that the [insurer's] decision was improperly motivated"); *Kirk v. Readers Digest Ass'n, Inc.*, 57 Fed. Appx. 20, 24-25 (2d Cir. 2003) (holding that in cases of conflicted administrators, "that conflict becomes a factor in our application of arbitrary and capricious review" when plaintiff failed to produce evidence proving administrator was influenced by the alleged conflict).

⁹³ Nola A. Kohler, *An Overview of the Inconsistency Among the Circuits Concerning the Conflict of Interest Analysis Applied in an ERISA Action with an Emphasis on the Eighth Circuit's Adoption of the Sliding Scale Analysis in Woo v. Deluxe Corporation*, 75 N.D. L. REV. 815, 827 (1999) [hereinafter "*Conflict of Interest Analysis*"].

⁹⁴ Kennedy, *supra* note 4, at 1150-62.

⁹⁵ *Sullivan v. LTV Aerospace & Defense Co.*, 82 F.3d 1251, 1255-56 (2d Cir. 1996).

⁹⁶ *Id.*

⁹⁷ *Id.*

⁹⁸ *Id.* at 1256.

⁹⁹ See *Doyle v. Paul Revere Life Ins. Co.*, 144 F.3d 181, 184 (1st Cir. 1998); *Pinto v. Reliance Standard Life Ins. Co.*, 214 F.3d 377, 391 (3d Cir. 2000); *Doe v. Group Hospitalization & Med. Servs.*, 3 F.3d 80, 87 (4th Cir. 1993); *Vega v. Nat'l Life Ins. Servs.*, 188 F.3d 287, 296 (5th Cir. 1999); *Miller v. Metro. Life Ins. Co.*, 925 F.2d 979, 984-85 (6th Cir. 1991); *Van Boxel v. Journal Co. Employee's Pension Trust*, 836 F.2d 1048, 1052-53 (7th

Essentially, the courts in these circuits adjust the level of deference given a plan administrator depending on the degree of the conflict in a given situation, apparently in an attempt to neutralize the conflicted decision. This approach appears to be favored by the majority of circuits because it allows the courts to comply with the Supreme Court's *Firestone* mandate to use an abuse of discretion standard while weighing the conflict as a "factor in determining whether there is an abuse of discretion."¹⁰⁰

3. Presumptively Void Standard: Ninth and Eleventh Circuits

In the Ninth and Eleventh Circuits, if the court finds that a plan administrator's conflict of interest influenced his decision, there is a presumption that the decision is void.¹⁰¹ The burden then shifts to the administrator to prove the conflict of interest did not affect its decision.¹⁰² If the plan administrator cannot rebut the presumption, the court reviews the plan administrator's decision under a more searching standard of review.¹⁰³

The difference in application of the standard of review by the various circuits in conflicted administrator situations is exacerbated when the plan is a top hat plan. This is so because top hat plans are not administered by a fiduciary with an obligation to make plan decisions in the best interest of the plan participant. Thus, with the circuit courts in disagreement as to the standard of review for plans administered by fiduciaries, there is little likelihood that consistency among the circuit courts will result when the standard of review is applied to top hat plans, without either legislative changes to ERISA or further interpretation by the Supreme Court itself.¹⁰⁴

III. ANALYSIS

A. Top Hat Plans Should be Removed from ERISA's Purview

Top hat plans are unique among ERISA benefit plans.¹⁰⁵ While participants must utilize ERISA's enforcement provisions to challenge benefit deni-

Cir. 1988); *Schatz v. Mut. of Omaha Ins. Co.*, 220 F.3d 944, 947 (8th Cir. 2000); *Pitman v. Blue Cross*, 217 F.3d 1291, 1297 (10th Cir. 2000).

¹⁰⁰ *Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101, 115 (1989), *aff'g in part, rev'g in part*, 828 F.2d 134 (3d Cir. 1987), *aff'g in part, rev'g in part*, 640 F. Supp. 519 (E.D. Pa. 1986). (quoting RESTATEMENT (SECOND) OF TRUSTS § 187, cmt. d (1959)).

¹⁰¹ *Lang v. Long-Term Disability Plan of Sponsor Applied Remote Tech., Inc.*, 125 F.3d 794, 797 (9th Cir. 1996); *Brown v. Blue Cross & Blue Shield of Ala., Inc.*, 898 F.2d 1556, 1564 (11th Cir. 1990).

¹⁰² *Atwood v. Newmont Gold Co.*, 45 F.3d 1317, 1322-23 (9th Cir. 1995); *Brown*, 898 F.2d at 1564.

¹⁰³ *Atwood*, 45 F.3d at 1323 (if the conflicted plan administrator cannot carry the burden of showing the conflict did not influence its decision to deny the benefit, the review will be *de novo*); *Brown*, 898 F.2d at 1568 (a fiduciary operating under a conflict of interest is entitled to the arbitrary and capricious standard of review but "the degree of deference actually exercised in application of the standard will be significantly diminished").

¹⁰⁴ Indeed, some courts do not even recognize the distinction between the fiduciary duties of administrators of funded plans and the non-fiduciary interests of top hat plan administrators. See *Olander v. Bucyrus-Erie Co.*, 187 F.3d 599, 607 (7th Cir. 1999).

¹⁰⁵ *Goldstein v. Johnson & Johnson*, 251 F.3d 433, 442 (3d Cir. 2001) (stating "a top hat plan is a unique animal under ERISA's provisions. These plans are intended to compensate

als, none of the substantive provisions of ERISA apply to top hat plans.¹⁰⁶ It is just this position – being “not all the way in” ERISA, yet still bound by ERISA – that imposes hardships on top hat participants by preempting state law causes of action, while simultaneously benefiting employers in the denial of top hat benefit claims.¹⁰⁷ ERISA’s preemption clause was intended to provide uniformity in the administration of pension plan benefits, but the result is that the preemption clause is now being used as a shield for plan administrators and insurers to limit their liability by invoking ERISA’s preemption of state law causes of action even when ERISA provides no remedy.¹⁰⁸ This result is incompatible with ERISA’s objective of protecting participants’ rights.¹⁰⁹

Congress should amend ERISA to exempt top hat plans from ERISA’s coverage, much as it presently does with unfunded excess benefit plans.¹¹⁰ There are two primary reasons for this proposal: first, top hat plans do not fit within the trust-like environment of ERISA and more closely resemble unilateral contracts; and second, the rationale Congress used to exempt top hat participants from ERISA’s substantive provisions is not sound and works against such participants, binding them to ERISA’s enforcement provisions while precluding breach of contract actions.

1. Top Hat Plans are Unilateral Contracts, Not Trusts

A trust is a fiduciary relationship with respect to property arising from a manifestation of intention to create that relationship and subjecting the person who holds title to the property to duties to deal with it for the benefit of . . . one or more persons, at least one of whom is not the sole trustee.¹¹¹

Top hat plans possess none of the elements of a trust. There is no trust property because, by definition, top hat plans must be unfunded.¹¹² Because a top hat plan is unfunded, there is no property transfer from a settlor to a trustee; similarly, there is no legal title held for the benefit of a beneficiary holding equitable title. Top hat plan administrators are exempted from ERISA’s fiduciary responsibilities and, as such, have no duty to act in the plan participant’s

only highly-paid executives, and the Department of Labor has expressed the view that such employees are in a strong bargaining position relative to their employers and thus do not require the same substantive protections that are necessary for other employees.”).

¹⁰⁶ 29 U.S.C. §§ 1051(2), 1081(a)(3), 1101(a)(1) (2000).

¹⁰⁷ Kennedy, *supra* note 4, at 1091 (summarizing ERISA’s preemption clause as broadly construed to restrict and preempt state contract and tort causes of action, leaving only ERISA’s federal causes of action as a participant’s only form of remedy).

¹⁰⁸ See e.g., *In re White Farm Equip. Co.*, 788 F.2d 1186 (6th Cir. 1986) (citing 120 CONG. REC. S15751 (daily ed. Aug. 22, 1974) (remarks of Sen. Javits)); *Cannon v. Group Health Serv. of Okla., Inc.*, 77 F.3d 1270, 1274 (10th Cir. 1996).

¹⁰⁹ Kennedy, *supra* note 4.

¹¹⁰ The unfunded excess benefit plan differs from the top hat plan, because the unfunded excess benefit plan is not subject to either the enforcement or substantive provisions of ERISA. “In terms of design, the difference between a top hat plan and an excess benefit plan is, in most circumstances, that the top hat plan can have multiple broad purposes, while an excess benefit plan has the sole purpose of avoiding the limitations imposed by § 415 of the Internal Revenue Code.” *Garratt v. Knowles*, 245 F.3d 941, 946 (7th Cir. 2001).

¹¹¹ RESTATEMENT (THIRD) TRUSTS § 2 (2003).

¹¹² 29 U.S.C. § 1081(a)(3) (2000).

best interest.¹¹³ In spite of these facts, top hat participants are limited to ERISA's federal causes of action as their only remedies.¹¹⁴

In *Firestone*, the Supreme Court stated that "[t]rust principles make a deferential standard of review appropriate when a trustee exercises discretionary powers,"¹¹⁵ regardless of whether the plan is funded or unfunded and without regard to whether the administrator or fiduciary is operating under a conflict of interest.¹¹⁶ But when applied to the unilateral contract-like top hat plan, the awarding of discretionary authority is lethal to a claimant's cause of action.

In a top hat plan, the plan administrator is not a fiduciary within trust law terms – the administrator has no obligation to act in the participant's interest at all. Then to allow the addition of simple discretionary authority language to cloak the administrator with an abuse of discretion review leaves the claimant with no ability to pursue an action unless he can prove the administrator acted in an arbitrary or capricious manner. Additionally, the claimant is foreclosed from pursuing state law causes of actions because of ERISA's preemption clause.¹¹⁷

Some courts of appeal have rejected applying the Supreme Court's *Firestone* standard of review mandate to top hat plans reasoning that, because top hat plans are not trusts, the *Firestone* decision does not apply to top hat plans.¹¹⁸ These courts characterize top hat plans as being akin to unilateral contracts rather than fitting within ERISA's trust premise.¹¹⁹

The Third Circuit has "routinely" treated top hat plans differently from other ERISA plans.¹²⁰ In *Goldstein v. Johnson & Johnson*, the Third Circuit applied contract law principles to resolve an ERISA top hat claim, and concluded that the top hat plan should be treated as a unilateral contract.¹²¹ In *Kemmerer v. ICI Americas Inc.*, the Third Circuit concluded that the exemption from ERISA's fiduciary provisions differentiates top hat plans from funded

¹¹³ *Id.* § 1101(a)(1).

¹¹⁴ *Id.* § 1144(a).

¹¹⁵ *Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101, 111 (1989), *aff'g in part, rev'g in part*, 828 F.2d 134 (3d Cir. 1987), *aff'g in part, rev'g in part*, 640 F. Supp. 519 (E.D. Pa. 1986).

¹¹⁶ *Id.* at 115.

¹¹⁷ 29 U.S.C. § 1144(a).

¹¹⁸ *Goldstein v. Johnson & Johnson*, 251 F.3d 433, 442 (3d Cir. 2001) ("We have held that [top hat] plans are more akin to unilateral contracts than to the trust-like structure normally found in ERISA plans. Accordingly, top hat plans are not subject to any of ERISA's substantive provisions, including its requirements for vesting and funding . . . the administrators of these plans [are] not subject to ERISA's fiduciary requirements . . ."); *see also In re New Valley Corp.*, 89 F.3d 143, 149 (3d Cir. 1996); *Carr v. First Nationwide Bank*, 816 F.Supp. 1476, 1492 (N.D.Cal. 1993) (holding that top hat plans should be interpreted in keeping with the principles that govern unilateral contracts).

¹¹⁹ *Pratt v. Petroleum Prod. Mgmt. Employee Sav. Plan*, 920 F.2d 651, 661 (10th Cir. 1990) (quoting *Hurd v. Illinois Bell Tel. Co.*, 234 F.2d 942, 946 (7th Cir.) *cert. denied*, 352 U.S. 918 (1956) ("A pension plan is a unilateral contract which creates a vested right in those employees who accept the offer it contains by continuing in employment for the requisite number of years."); *Carr*, 816 F.Supp. at 1488 ("Pension benefit plans are unilateral contracts which employees accept by appropriate performance.").

¹²⁰ *Goldstein*, 251 F.3d at 436 (referencing *In re New Valley*, 89 F.3d at 143 and *Kemmerer v. ICI Americas Inc.*, 70 F.3d 281 (3d Cir. 1995)).

¹²¹ *Id.* at 443.

benefit plans in the remedy available.¹²² In *In re New Valley Corp.*, the court reasoned “[t]op hat employees have rights only under the contract. Where a contract action fails, they have no recourse. Welfare benefit plan participants, by contrast, enjoy an action for breach of fiduciary duty. Top hat participants have no such alternative remedy. They must seek their remedy in contract law.”¹²³

In *Kemmerer*, the Third Circuit applied unilateral contract principles to an ERISA claim brought by participants against their employer for terminating a top hat plan.¹²⁴ The court stated, “once the employee performs, the offer becomes irrevocable, the contract is completed, and the employer is required to comply with its side of the bargain.”¹²⁵ Agreeing with *Carr v. First Nationwide Bank*,¹²⁶ the Third Circuit said that, even when a plan reserves the ability for the plan sponsor to terminate the plan, a participant’s acceptance by performance “closes that door under unilateral contract principles.”¹²⁷ To interpret a top hat plan in any other way “would make the plan’s several specific and mandatory provisions ineffective, rendering the promises embodied therein completely illusory.”¹²⁸

In *Spacek v. Maritime Association*,¹²⁹ the Fifth Circuit considered a case where the employer amended a pension plan after an employee’s retirement, and the employee sued under ERISA claiming a reduction in benefits.¹³⁰ In distinguishing the “ordinary pension plan before it” from top hat plans, the court recognized that, because top hat plans are not subject to ERISA’s “full panoply of regulations,” top hat plans are similar to pre-ERISA pension plans in that “no statutory mechanism exists to safeguard the expectations of top hat plan participants in obtaining their deferred compensation.”¹³¹ The *Spacek* court explained that, absent such a safeguard, an equity argument exists for applying contract law to top hat cases, similar to contract analysis favoring the pensioner in pre-ERISA pension plan cases.¹³²

The *Spacek* court further expanded on the problems of including top hat plans in ERISA without providing the same protections to top hat participants

¹²² *Kemmerer*, 70 F.3d at 286-87.

¹²³ *In re New Valley*, 89 F.3d at 153-54.

¹²⁴ *Kemmerer*, 70 F.3d at 285.

¹²⁵ *Id.* at 287.

¹²⁶ *Carr v. First Nationwide Bank*, 816 F.Supp. 1476, 1488 (N.D. Cal. 1993)

¹²⁷ *Kemmerer*, 70 F.3d at 288 (quoting *Carr*, 816 F.Supp. at 1494).

¹²⁸ *Kemmerer*, 70 F.3d at 288. The Third Circuit stated:

Congress exempted top hat plans from ERISA’s vesting requirements in large part because it recognized that high level executives retain sufficient bargaining power to negotiate particular terms and rights under the plan and therefore do not need ERISA’s substantive rights and protections. This being so, “it would be absurd to deny such individuals the ability to enforce the terms of their plans in contract . . . it would be difficult to imagine what top hat participants would have the power to obtain through negotiation or otherwise – apparently not much more than illusory promises.”

Id. (citing *Kemmerer v. ICI Americas, Inc.*, 842 F.Supp. 138, 144 (E.D.Pa. 1994) (quoting *Carr*, 816 F.Supp. at 1492)).

¹²⁹ *Spacek v. Maritime Assoc.*, I L A Pension Plan, 134 F.3d 283 (5th Cir. 1998).

¹³⁰ *Id.*

¹³¹ *Id.* at 296.

¹³² *Id.*

as to any other pension participant. Specifically, the court said that a promise is illusory if it creates no obligation on the part of the purported promisor.¹³³ The court said:

Interpreting a broad amendment provision in a top hat plan to allow an employer to . . . sharply diminish the benefits that it provides renders the employer's obligations under the plan illusory because . . . the employer has no duty of performance under the plan. This is not the case with an ordinary pension plan subject to all of ERISA's statutory safeguards because the backdrop of ERISA guarantees that the employer will have some obligation of performance under the pension plan.¹³⁴

If top hat plans were removed entirely from ERISA, a claimant would be able to file state contract or tort causes of action and would have the opportunity for a jury trial – alternatives foreclosed to claimants today under ERISA's enforcement provisions.¹³⁵ Participants would not be misled into believing their pension benefits were protected because they were "ERISA-covered plans." Plan administrators would not be able to automatically invoke the *Firestone* protection of writing discretionary authority into their plans, and instead would be uniformly subjected to a *de novo* standard of review.

1. DOL's Explanation of Executives' Bargaining Power May Have Been Overstated

Congress excluded executives and highly compensated individuals from ERISA's substantive protections because it decided these individuals "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"¹³⁶ However, the presumption that top hat participants have the ability to negotiate their pension plans is not entirely realistic. Certainly some top hat participants have this ability, but to apply a blanket assertion to the entire class of top hat participants seems overly broad.¹³⁷

One court noted that the justification for excluding top hat participants from ERISA's substantive provisions recognizes that "the persons to be aided by the statute lacked sufficient economic bargaining power to obtain contractual rights to nonforfeitable benefits."¹³⁸ But simply because funded pension plan participants were deemed to be *more* in need of contractual rights to nonforfeitable benefits does not imply that *all* top hat participants have *no* need for those same contractual rights. The exclusion of top hat participants from

¹³³ *Id.* at 297.

¹³⁴ *Id.* (emphasis added).

¹³⁵ Baker, *supra* note 36, at 538-39.

¹³⁶ DOL Office of Pension & Welfare Benefit Programs, Opinion 90-14 A, 1990 WL 123933, at *1 (May 8, 1990).

¹³⁷ See *Matthews v. Sears Pension Plan*, 144 F.3d 461, 465 (7th Cir. 1998) (observing that pension plans are usually not negotiated).

¹³⁸ *Darden v. Nationwide Mut. Ins. Co.*, 796 F.2d 701, 706-07 (4th Cir. 1986), *on remand*, 717 F.Supp. 388 (E.D.N.C. 1989), *aff'd*, 922 F.2d 203 (4th Cir. 1991), *rev'd on other grounds*, 503 U.S. 318 (1992).

ERISA's substantive provisions is contrary to the policy interest in protecting pension benefit rights as a whole.¹³⁹

Further, because ERISA derived in part from the Labor Management Relations Act (LMRA),¹⁴⁰ Congress must have realized that collectively-bargained benefit plans comprise a significant percentage of all benefit plans. In fact, thirty-one percent of those participants covered by pension plans in 1995 were participants in collectively-bargained plans.¹⁴¹ By the very nature of collective bargaining, the terms, design, and operation of those pension plans were affected or influenced by the plan participant, through his elected labor union representative's negotiations and the participant's personal vote to accept the collectively-bargained agreement.

So, while it is absolutely certain that those participants represented by labor unions have negotiated the terms and design of their pension plans, every one of those participants enjoys the funding, vesting, and fiduciary protections inherent in ERISA. Conversely, top hat plan participants, limited to "a select group of management or highly compensated employees,"¹⁴² are entirely excluded from the same protections given other participants who "have the ability to affect or substantially influence, through negotiation or otherwise" their benefit plans.¹⁴³

Although the meaning of the term "highly compensated" is not defined within ERISA, it was found to apply in one recent case where the average salary of plan participants was "around \$30,000 a year."¹⁴⁴ It is hard to imagine that, when Congress enacted ERISA in 1974, it intended to exclude employees earning "around \$30,000" in 1997 from the substantive protections ERISA provides other benefit plan participants, simply because others within that organization earned even less.

Finally, there is no requirement in ERISA that top hat participants have the ability to negotiate the terms and conditions of top hat plans, even though courts have accepted the DOL's explanation regarding Congress's exclusion of top hat participants from ERISA's substantive provisions.¹⁴⁵ And, in the context of ERISA's intended protective functions, the exclusion of *all* top hat par-

¹³⁹ *Spacek v. Maritime Assoc., I L A Pension Plan*, 134 F.3d 283, 295 (5th Cir. 1998). (stating courts have traditionally protected the rights of pensioners "who have labored the greater portion of their lives under an expectation that their hard work would bring them security in retirement.").

¹⁴⁰ *Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101, 109 (1989), *aff'g in part, rev'g in part*, 828 F.2d 134 (3d Cir. 1987), *aff'g in part, rev'g in part*, 640 F. Supp. 519 (E.D. Pa. 1986). (noting Congress's intent to incorporate LMRA fiduciary law into ERISA).

¹⁴¹ United States DOL, Pension & Welfare Benefits Administration, *Abstract of 1995 Form 5500 Annual Reports, Private Pension Plan Bulletin No. 8*, (Spring 1999) at http://www.dol.gov/ebsa/programs/opr/bullet1995/a_6.htm (indicating that, of a total of 87,452,000 participants in pension plans in 1995, 27,098,000 were participants in collectively-bargained plans) (last visited Feb. 19, 2005).

¹⁴² 29 U.S.C. § 1101(a)(1).

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

¹⁴⁴ *Demery v. Extebank Deferred Comp. Plan (B)*, 216 F.3d 283, 289 (2d Cir. 2000) (concluding that because the average salary of plan participants was more than double that of the average salary of all other bank employees, the plan participants were highly compensated within the meaning of ERISA).

¹⁴⁵ *Baker*, *supra* note 36, at 507.

ticipants on the basis that some of them *may* have the ability to negotiate their plans seems contrary to ERISA's goal of "interject[ing] elements of fairness, disclosure, and due process to participants/beneficiaries under [benefit] plans."¹⁴⁶

B. Top Hat Plans Should Be Included in ERISA

Instead of removing top hat plans from ERISA's coverage, Congress could alternatively amend ERISA to apply most of its substantive provisions to these plans, just like other pension benefit plans. While the rationale for applying ERISA's protections to top hat plans is sound, the consequences of top hat plans effectively becoming "qualified" plans are more complex and controversial.

1. Rationale for Applying ERISA's Substantive Provisions to Top Hat Plans

ERISA's purpose is to provide comprehensive protection for private-sector employee benefit plan participants.¹⁴⁷ One of Congress's primary reasons for passing ERISA was to protect plan participants' expectations for benefits promised by employers.¹⁴⁸ But, because of ERISA's regulatory structure, top hat plan participants' expectations are not protected by ERISA's substantive provisions.¹⁴⁹

Congress exempted top hat plans on the basis that participants were sophisticated enough to negotiate or influence their own deferred compensation plans, "taking into consideration any risks attendant thereto, and, therefore, would not need the substantive rights and protections of Title I."¹⁵⁰ However, the risks attendant to top hat plans have very little to do with the ability of executives to influence their benefit plans or the executives' performance and more to do with the financial health of the employer. Given the increasing numbers of corporate mergers and acquisitions ("change of control" events), during which executives are particularly vulnerable, top hat benefits may be lost entirely because of events over which the executive has no control, or had no knowledge of at the time the executive became eligible in the top hat plan.¹⁵¹

In most cases, losses under [a top hat plan] will occur because of changes in the financial condition of the employer. It is impossible to anticipate such

¹⁴⁶ Kennedy, *supra* note 4, at 1175.

¹⁴⁷ 29 U.S.C. §§ 1001(b), (c) (2000).

¹⁴⁸ *Barrowclough v. Kidder, Peabody & Co.*, 752 F.2d 923, 929 (3d Cir. 1985).

¹⁴⁹ Top hat plans are exempt from the participation and vesting rules of Part 2, 29 U.S.C. §1051(2); the funding rules of Part 3, 29 U.S.C. §1081(a)(3); and the fiduciary responsibility rules of Part 4, 29 U.S.C. §1101(a)(1).

¹⁵⁰ DOL Office of Pension & Welfare Benefit Programs, Opinion 90-14 A, 1990 WL 123933, at *1 (May 8, 1990).

¹⁵¹ Carter G. Bishop & Marian McMahon Durkin, *Nonqualified Deferred Compensation Plans: A Review and Critique*, 17 WM. MITCHELL L. REV. 43, 85 (1991). The authors continue, "[i]f one accepts the premise that retirement benefits should not be gambled on the financial security of the employer, it is unacceptable that [top hat plans] should continue to fall outside of ERISA's regulatory protection." *Id.*

events as unknown future competition, technology changes, or litigation. *Position and power have little to do with forecasting unknown events.*¹⁵²

At the time of ERISA's enactment, when Congress decided to exempt top hat plans from ERISA's substantive protections, change of control events were not as commonplace as they have since become.¹⁵³ Top hat participants are no less deserving of having their retirement benefits protected than other plan participants, and should be provided the same level of protection for their benefit plans.

2. *Effect of Qualified Status on Top Hat Plans*

The tax treatment of qualified and nonqualified ERISA plans is complex and governed by two enormous statutes: ERISA and IRC. Even those well versed in the area of nonqualified deferred compensation plans caution that the complexity is beyond all but tax experts.¹⁵⁴

Generally, there are income tax benefits to participants in top hat plans that are unavailable in other plans. A top hat plan is an unfunded, non-qualified deferred compensation plan. The participant is taxed at the time he receives the deferred compensation, not at the time it is earned. The employer is able to take a tax deduction at the time it pays the benefit. Likewise, a participant in a qualified (funded) plan is not taxed until he receives a distribution from the funded plan, which is usually at retirement, while the employer is able to take a tax deduction at the time it makes the contribution to the plan.

However, the amount that can be contributed to a qualified plan is limited by the IRC.¹⁵⁵ These restrictions limit the amount of benefits available to highly compensated or executive management personnel, who then turn to non-qualified benefit plans to supplement the restricted qualified benefit amount.

Employers have sound business reasons for preferring the payment of deferred compensation to executives, instead of paying all compensation as current cash compensation. These reasons often include tying executive compensation to performance, or subjecting compensation to forfeiture on subsequent employment with a competitor. At the same time, the incentives for avoiding ERISA funding are based on avoiding immediate taxation of the employee when the compensation is deferred, and avoiding ERISA's minimum coverage and participation rules (the "anti-discrimination" rules).¹⁵⁶

¹⁵² *Id.* (emphasis added). The authors additionally posit "[t]he loss of retirement security cannot be justified on any grounds: the loss cannot be remedied. Justifying the lack of DOL and ERISA intervention on the grounds that executives can take care of themselves simply misses the point." *Id.*

¹⁵³ In fact, change of control events that can affect top hat plan participants increased by 458% between 1985 and 1999. U.S. Census Bureau, *Statistical Abstract of the United States: 2001*, Table No. 742 Mergers and Acquisitions – Summary: 1985 to 1999, at <http://www.census.gov/prod/2002pubs/01statab/business.pdf> (last visited Feb. 1, 2005).

¹⁵⁴ Bishop & Durkin, *supra* note 151, at 43. "The breadth, complexity and interrelationship of the labor and tax regulatory regimes confine the understanding of the conditions of the deferral to sophisticated tax planners." *Id.*

¹⁵⁵ I.R.C. § 401(a) (2002).

¹⁵⁶ Bishop & Durkin, *supra* note 151 (noting, however, that to receive the deferred tax benefit "[t]he employee must accept full economic risk of the employer not being able to pay the deferred compensation when due because of financial failure.").

The inclusion of top hat plans in ERISA's substantive protections would require that top hat plans become funded plans. Once a plan is funded, it becomes subject to ERISA's fiduciary duties, thus affording immediate protection to the plan participant. Top hat plans would remain non-qualified plans, however, because they provide benefits in excess of those permitted under the qualified plan limitations. The compensation would be taxed to the employee at the time of funding, usually when the compensation was actually earned, which would eliminate the employee's benefit of tax deferral. Even without a tax advantage to the plan participant, however, some commentators argue that top hat plans would remain viable because they would continue to be used as a method for executives to increase their retirement benefits.¹⁵⁷ Most importantly, the plan participant could rely upon the security of the top hat plan benefit, as does every other ERISA-covered plan participant.

To include top hat plans in ERISA's substantive protections, however, one exception must still be made: top hat plans must remain exempt from ERISA's anti-discrimination clause to allow these plans to remain limited to highly compensated or management employees.¹⁵⁸

Thus, for top hat plans to be covered by ERISA's substantive protections, many factors would have to change: the employer would have to fund the plan as the benefit accrued; the plan administrator would assume fiduciary responsibilities to the plan participants; and the employee would be taxed at the time the compensation was deferred, all while keeping top hat plans exempt from ERISA's anti-discrimination clause. It seems unlikely these changes could easily be made in order to afford top hat plan participants a greater amount of retirement security. To do so would result in potential hardship for the employer (funding the plan earlier rather than later) and for the employee (paying taxes on deferred compensation earlier rather than later), in addition to requiring congressional action altering the structure of ERISA.

C. Courts Should Apply a De Novo Standard of Review in Top Hat Benefits Denial Cases

It is unlikely that Congress will amend ERISA to protect top hat participants. Those individuals deemed "highly compensated" or "management employees" are not generally as sympathetic as average working-class employees. Because top hat participants are limited in number, there is not much visibility when plan administration injustices occur, or when these few individuals find themselves without their anticipated retirement security later in life.

But the fact that top hat participants are few in number, not as sympathetic, and not as visible does not justify inequitable administration of retirement benefits. In the absence of congressional action to amend ERISA to remedy the unfairness inherent in the administration of top hat plans, the courts should uniformly apply a *de novo* standard of review to plan administrator decisions in top hat benefits denial cases. In other words, a top hat plan administrator should not be able to establish a deferential judicial standard of review

¹⁵⁷ *Id.* at 48.

¹⁵⁸ *Id.* at 54.

by writing language that gives itself discretionary authority in a plan in which it owes no loyalty or fiduciary responsibilities to the plan participants.

1. *Inherent Conflict of Administrator*

Top hat plans are exempt from ERISA's funding provisions.¹⁵⁹ Because these plans are unfunded, the employer pays the benefits from its general assets at the time the payments are due to the plan participant. An inherent conflict of interest arises in top hat plan benefits denials because, in deciding eligibility and interpreting the provisions of the plan, the plan administrator's decision will always directly and immediately impact the cost to the employer.¹⁶⁰ If the plan administrator approves the benefit payment, the employer must pay these unfunded benefits from its general assets.¹⁶¹ Conversely, if the plan administrator denies payment of the unfunded benefit, there is no cost to the employer under the plan.¹⁶²

The Eleventh Circuit's seminal case for standard of review of a conflicted fiduciary, while not directly on point for non-fiduciary administrators in top hat plans, is nonetheless instructive on the level of deference to be accorded administrators operating under a conflict of interest. In *Brown v. Blue Cross and Blue Shield of Alabama*,¹⁶³ the court declined to apply the highly deferential arbitrary and capricious or abuse of discretion standard of review because of an insurance company's conflict of interest in administering an ERISA benefits plan.¹⁶⁴

In *Brown*, the insurance company denied coverage that, had it been approved, would have been paid out of its general funds.¹⁶⁵ Absent this conflict, the insurance company would have received *Firestone's* deferential abuse of discretion standard of review.¹⁶⁶ However, the *Brown* court implemented what it called a "heightened arbitrary and capricious" standard of review, noting the "inherent conflict between the fiduciary role and the profit-making objective of an insurance company makes a highly deferential standard of review inappropriate."¹⁶⁷ The court reasoned that as a fiduciary, the principles of trusts entitled the plan administrator's decision to a review by the arbitrary and capricious standard, but that "the degree of deference actually exercised in application of the standard will be significantly diminished" when a conflict of interest exists.¹⁶⁸ The court considered and dismissed reviewing the administrator's decision *de novo* on the grounds that, as a fiduciary, the insurance company had a duty of loyalty to the plan participants and was thus to be accorded some level of deference.¹⁶⁹

¹⁵⁹ 29 U.S.C. § 1081(a)(3) (1999).

¹⁶⁰ Kennedy, *supra* note 4, at 1147-48.

¹⁶¹ *Id.* at 1147.

¹⁶² *Id.* at 1148.

¹⁶³ 898 F.2d 1556 (11th Cir. 1990).

¹⁶⁴ *Id.* at 1558.

¹⁶⁵ *Id.*

¹⁶⁶ *Id.* at 1562.

¹⁶⁷ *Id.*

¹⁶⁸ *Id.* at 1568.

¹⁶⁹ *Id.* at 1563.

A top hat administrator lacks any such duty of loyalty or other fiduciary duty.¹⁷⁰ Where insurance companies have been exempted from the ERISA provisions that require that "all assets of an employee benefit plan shall be held in trust by one or more trustees,"¹⁷¹ insurance claims remain subject to state laws that regulate insurance.¹⁷² Conversely, a top hat plan participant is precluded from any state law actions to enforce a top hat plan.¹⁷³

The underlying rationale of *Brown* is that a fiduciary's self-interest may compromise the fiduciary's duty of loyalty to plan participants.¹⁷⁴ In top hat plans, however, the plan administrator's conflict is always inherent: with absolutely no fiduciary responsibilities, the administrator determines whether to pay a benefit, not from any designated fund, but from the administrator's current assets.¹⁷⁵

2. *The Trust-Law Based Abuse of Discretion Standard of Review is Not Appropriate for Contract-Based Top Hat Plans*

In its *Firestone* decision, the Supreme Court recognized that the trust law *de novo* standard of review was in accordance with courts' interpretation of benefit plans before Congress enacted ERISA.¹⁷⁶ Prior to ERISA's enactment, suits challenging a plan administrator's denial of benefits were governed by principles of contract law.¹⁷⁷ However, based on ERISA's trust-like structure, the Court also stated that "[t]rust principles make a deferential standard of review appropriate when a trustee exercises discretionary powers."¹⁷⁸

In top hat benefit denial cases, when the employer is additionally the administrator and fund provider, an inherent conflict of interest exists.¹⁷⁹ As the Eleventh Circuit recognized some time ago, "inasmuch as '[t]he basis for the deferential standard of review in the first place was the trust nature of most ERISA plans,' the most important reason for deferential review is lacking."¹⁸⁰

¹⁷⁰ 29 U.S.C. § 1101(a)(1) (1999).

¹⁷¹ 29 U.S.C. § 1103(a).

¹⁷² 29 U.S.C. § 144(b)(2)(A).

¹⁷³ 29 U.S.C. § 1144(a).

¹⁷⁴ *Torres v. Pittston Co.*, 346 F.3d 1324, 1330 (11th Cir. 2003).

¹⁷⁵ *But see* *Scipio v. United Nat'l Bankshares, Inc.*, 284 F. Supp. 2d 411 (N.D. W. Va. 2003). The court agreed with the proposition that a court should not act as deferentially as would otherwise be appropriate when a fiduciary exercised discretion in the interpretation of a disputed term and the fiduciary's interpretation furthered its own interest. Even so, the court then concluded that the amount of money in dispute – \$2,000,000 – was not significant to the plan administrator, so even though the decision was made to benefit the fiduciary, the deferential abuse of discretion standard applied in reviewing the plan administrator's decision. *Id.* at 419.

¹⁷⁶ *Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101, 112 (1989), *aff'g in part, rev'g in part*, 828 F.2d 134 (3d Cir. 1987), *aff'g in part, rev'g in part*, 640 F. Supp. 519 (E.D. Pa. 1986).

¹⁷⁷ *Id.*

¹⁷⁸ *Id.* at 111 (emphasis added).

¹⁷⁹ *Kennedy*, *supra* note 4, at 1150.

¹⁸⁰ *Brown v. Blue Cross & Blue Shield of Ala., Inc.*, 898 F.2d 1556, 1561 (11th Cir. 1990) (quoting *Moon v. American Home Assurance Co.*, 888 F.2d 86, 89 (11th Cir. 1989)).

A comparison of top hat plans to trusts is unworkable.¹⁸¹ The exclusion of all of the trust principles from top hat plans makes these unfunded benefit plans unilateral contracts.¹⁸² In *Goldstein*,¹⁸³ the Third Circuit distinguished top hat plans from other ERISA plans by pointing to the lack of trust provisions applicable to top hat plans, as opposed to the substantive ERISA provisions used to protect funded benefit plans.¹⁸⁴

In rejecting the Supreme Court's *Firestone* holding that the deferential standard of review applied to plan administrators exercising discretionary authority, the *Goldstein* court made the "emperor is wearing no clothes" observation that *Firestone* was "premised on the analogy of an ERISA plan to a traditional trust."¹⁸⁵ However, "[g]iven the unique nature of top hat plans," the Third Circuit "believe[d] the holding of *Firestone* requiring deferential review for the discretionary decisions of administrators to be inapplicable."¹⁸⁶

The *Goldstein* court concluded that top hats plans more closely resemble a different situation identified by the Supreme Court in *Firestone* where a plan administrator does not have discretion to interpret the plan and is therefore not a fiduciary, in which case the plan is reviewed *de novo*, according to the federal common law of contract.¹⁸⁷

In contrast, the Seventh Circuit, in *Olander v. Bucyrus-Erie*,¹⁸⁸ applied the *Firestone* arbitrary and capricious standard of review to a top hat plan.¹⁸⁹ In *Olander*, a plan participant sued the plan administrator for excluding certain payments made to the participant from the administrator's compensation calculations.¹⁹⁰ Resolution of the dispute centered on whether the payments received by Olander were "compensation" for purposes of calculating plan benefits.¹⁹¹ Concluding the plan was a top hat plan subject to ERISA, the court gave a "high degree of deference" to the administrator's decision to exclude the payments on the basis that the administrator was a fiduciary.¹⁹² This result is particularly surprising, given that a top hat plan does not possess any of the

¹⁸¹ *Goldstein v. Johnson & Johnson*, 251 F.3d 433, 436 (3d Cir. 2001) (finding that "[b]ecause top hat plans are unfunded, do not vest, and their administrators have no fiduciary responsibilities to the plan participant, the analogy to trust law 'fails, and the plans are more appropriately considered as unilateral contracts, whereby neither party's interpretation is entitled to any more 'deference' than the other party's.'"); see also *In re New Valley Corp.*, 89 F.3d 143, 149 (3d Cir. 1996); *Kemmerer v. ICI Americas Inc.*, 70 F.3d 281, 287 (3d Cir. 1995).

¹⁸² *Goldstein*, 251 F.3d at 436 (stating "this Court has routinely treated top hat plans differently from other kinds of plans" because these plans are "expressly exempted from most of the substantive ERISA requirements normally employed to protect workers' interests in their plans").

¹⁸³ *Id.*

¹⁸⁴ *Id.*

¹⁸⁵ *Id.* at 436.

¹⁸⁶ *Id.* at 442.

¹⁸⁷ *Id.* at 443.

¹⁸⁸ *Olander v. Bucyrus-Erie Co.*, 187 F.3d 599 (7th Cir. 1999).

¹⁸⁹ *Id.*

¹⁹⁰ *Id.* at 602.

¹⁹¹ *Id.*

¹⁹² *Id.* at 607.

trust characteristics of a funded ERISA plan and its administrators are specifically exempt from any fiduciary duties.¹⁹³

The result of the Supreme Court's holding in *Firestone* also appears to conflict with ERISA's goal of providing a fair claims review process to plan participants.¹⁹⁴ To avoid a *de novo* review under *Firestone*'s holding, a plan sponsor merely has to add certain language to the plan to grant itself a more deferential judicial standard of review.¹⁹⁵ As the Court itself recognized, before ERISA was enacted, employee benefits denials were reviewed by the courts under contract law, and terms were interpreted *de novo* unless the employer was vested with final authority to determine benefit eligibility.¹⁹⁶ "The purpose of *de novo* review is to provide greater assurance that employees will get the benefits to which they are entitled under the written terms of plan documents."¹⁹⁷

A top hat plan supplemented with discretionary authority is, at most, an illusory promise. In another Seventh Circuit case where language in a benefits plan was determined insufficient to confer discretionary authority, Chief Judge Posner said "[a]n ERISA plan is a contract, and the meaning of a contract is ordinarily decided by the court, rather than by a party to the contract, let alone the party that drafted it."¹⁹⁸ This statement is equally applicable to top hat plans, if not more so, given the plan administrator's unfettered discretion and lack of fiduciary duties to the plan participant.

Unintentionally, the Ninth Circuit provided some support for applying a *de novo* standard of review to top hat plans in a dissenting opinion in *Kearney v. Standard Insurance*.¹⁹⁹ In that welfare benefit case, a plurality of the *en banc* court held that the language in a disability benefit plan required a *de novo* review of the administrator's record, because the language was insufficient to vest discretion in the plan administrator.²⁰⁰ The highly fractured court issued a decision that included the filing of six different opinions.²⁰¹

In his dissent, Judge Fernandez argued that the abuse of discretion standard should apply because the case before the court "*does not involve a mere contract; it involves an ERISA plan*. The difference is exceedingly important In an ordinary contract case, for example, one party is not a fiduciary for the other."²⁰² In arguing that ERISA plan decisions should be reviewed under

¹⁹³ *Goldstein*, 251 F.3d at 443 ("it is well established in the caselaw that there is no cause of action for breach of fiduciary duty involving a top hat plan"); *Demery v. Extebank Compensation Plan*, 216 F.3d 283, 290 (2d Cir. 2000) (dismissing breach of fiduciary duty claims under ERISA for a top hat plan because top hat plan administrators are not fiduciaries).

¹⁹⁴ *Kearney v. Standard Ins. Co.*, 175 F.3d 1084, 1102-03 (9th Cir. 1999).

¹⁹⁵ *Firestone*, 489 U.S. at 115.

¹⁹⁶ *Id.* at 112-13.

¹⁹⁷ *Orozco v. United Air Lines, Inc.*, 887 F.2d 949, 953 (9th Cir. 1989).

¹⁹⁸ *Herzberger v. Standard Ins. Co.*, 205 F.3d 327, 330 (7th Cir. 2000). The court, in finding the plan language insufficient to grant the plan administrator discretionary authority, also said "[a]n employer should not be allowed to get credit with its employees for having an ERISA plan that confers solid rights on them and later, when an employee seeks to enforce the right, pull a discretionary judicial review rabbit out of his hat." *Id.* at 332-33.

¹⁹⁹ *Kearney*, 175 F.3d at 1101 (Fernandez, J., dissenting).

²⁰⁰ *Id.* at 1090.

²⁰¹ *Id.* at 1084, 1096, 1099, 1101.

²⁰² *Id.* at 1101 (emphasis added).

the abuse of discretion standard of review, Judge Fernandez repeatedly made the point that mere contractual relationships do not provide as high a duty on the plan administrator as does an ERISA plan, because ERISA administrators have fiduciary duties to its participants.²⁰³ In three different sentences, the dissent mentioned how inappropriate it would be to bestow discretionary interpretation to a party of a simple contract.²⁰⁴

In fact, that is exactly the treatment of a top hat plan under ERISA – a top hat plan is treated as a contract in which one party has the ability to provide itself discretion to interpret the terms of the contract that the very party had a hand in writing.

Plan administrators are likely to object to a bright-line application of the *de novo* standard of review to top hat benefit claims denials, claiming increased litigation and the attendant increase in plan administration costs. Interestingly, in *Firestone*, the Court discussed Firestone's assertion that applying a *de novo* standard of review to an employer's denial of benefits would add to administrative and litigation expenses and thus discourage employers from implementing benefit plans.²⁰⁵ Justice O'Connor responded: "as to both funded and unfunded plans, the threat of increased litigation is not sufficient to outweigh the reasons for a *de novo* standard that we have already explained."²⁰⁶ This explanation holds up especially well when considering the possibility of increased litigation regarding top hat plan claim denials, because these plans are limited to a small population of executives and any increase in litigation will naturally be of a minimal amount.

Further, in *Orozco v. United Air Lines*,²⁰⁷ a Ninth Circuit welfare benefit case decided shortly after *Firestone*, the administrator argued that judicial review under the *de novo* standard would increase its liability because the court would "substitute its judgment for the judgment of [the] plan administrator."²⁰⁸ The Ninth Circuit pointed out that the *de novo* review itself would not increase the administrator's liability, but rather would "increase[] the chance that this court may disagree with [the administrator's] interpretation of the plan."²⁰⁹ The court said the administrator could not claim to suffer "substantial injustice because it was counting on the fact that [the court] would review with greater deference an interpretation of the plan which may not actually be supported by the plan's terms or the facts regarding the parties' intent"²¹⁰

The *Orozco* court reasoned that the *Firestone* decision requiring a *de novo* standard of review was in part "to remedy a situation in which participants in ERISA benefit plans were receiving less protection than they had been afforded

²⁰³ *Id.*

²⁰⁴ *Id.* (stating "we might be quite chary about bestowing a discretionary interpretation upon the words of an insurance, or other normal, contract"). *Id.* at 1102 (stating "it might seem a bit jarring to interpret ordinary contract language in a way that confers discretion, where one party must depend on the mere good faith of the other"). *Id.* (stating "[i]n [the case of a contract], the conferral of discretion may seem downright scary").

²⁰⁵ *Firestone*, 489 U.S. at 114.

²⁰⁶ *Id.* at 114-15.

²⁰⁷ *Orozco v. United Air Lines, Inc.*, 887 F.2d 949 (9th Cir. 1989).

²⁰⁸ *Id.* at 953.

²⁰⁹ *Id.*

²¹⁰ *Id.*

prior to adoption of ERISA.”²¹¹ This purpose should not be defeated by permitting an inherently-conflicted administrator to include plan language reserving to itself a discretionary judicial standard of review.

3. *Top Hat Plan Administrators Have Incentives to Deny Benefits*

ERISA fines and penalties do not apply to top hat plans.²¹² Because state contract claims such as fraud or misrepresentation are preempted, no punitive damages can be sought by top hat plan participants.²¹³ The court in its discretion may award attorneys fees to a successful claimant,²¹⁴ but those fees are limited to litigation expenses only and do not include the costs of the internal appeal process.²¹⁵ Even when a court decides to award attorneys fees, it may not award the full amount, because many courts apply a five-factor test that considers, among other things, the offending party’s ability to pay the fees.²¹⁶

So, the worst outcome for a plan administrator is that a court will order it to pay the benefit it was required to pay in the first place; and, no matter how arbitrary or capricious the denial of benefits, the administrator faces no further penalties or fines under ERISA.²¹⁷ With nothing left to chance, there is not anything to discourage a plan administrator from denying benefit claims and waiting to see if the plan participant has the financial wherewithal to incur litigation expenses in an attempt to establish his rightful claim.

IV. CONCLUSION

Congress enacted ERISA thirty years ago to protect retirement benefits of private sector employees and to create uniformity and minimum standards for the administration of ERISA plans. But, as applied to top hat plans, neither of these objectives has been met – by Congressional design, no less.

The deck is stacked against top hat plan participants. Top hat plans are subject to ERISA’s procedural requirements, but not to any of its substantive protections. A top hat plan administrator has no fiduciary responsibility to the plan participant, and the plan participant bears all the risk of whether funds will even be available at the point of termination or later, even though the partici-

²¹¹ *Id.*

²¹² 29 U.S.C. §§ 1132(l).

²¹³ 29 U.S.C. § 1144(a).

²¹⁴ 29 U.S.C. § 1132(g)(1).

²¹⁵ Michael A. McKuin, *ERISA*, at <http://hometown.aol.com/mmckuin/erisa-page2.html> (last visited Feb. 19, 2005).

²¹⁶ The remaining factors to be considered are: the degree of the offending party’s culpability or bad faith; whether an award of fees would deter others from acting similarly under like circumstances; the relative merits of the parties’ positions; and whether the action conferred a common benefit on a group of pension plan participants. *See, e.g.,* *Chambless v. Masters, Mates & Pilots Pension Plan*, 815 F.2d 869 (2d Cir. 1987); *Ellison v. Shenango Inc. Pension Bd.*, 956 F.2d 1268 (3d Cir. 1992); *Duggan v. Hobbs*, 99 F.3d 307, 314 (9th Cir. 1996); *Black v. Bresee’s Oneonta Dep’t. Store*, 919 F. Supp. 597 (N.D.N.Y. 1996) (while finding for plaintiff in an ERISA action, and admonishing the defendant for actions the court described as “unlawful,” “plainly unreasonable,” and culpable, the court still only awarded one-half plaintiff’s attorney’s fees).

²¹⁷ McKuin, *supra* note 215.

pant may have little or no ability to influence the circumstances that might place his retirement plan at risk.

In addition to having no obligation to act in the participant's best interest, plan administrators are permitted to control the judicial standard of review afforded them in any claim denial proceeding, simply by writing language in the plan document giving themselves discretionary authority. And, worse yet, because the plan administrator is also the funding source of the benefit plan, *every* decision made as to whether to approve or deny benefits has a direct impact on the profitability of the company – so the plan administrator operates under an ongoing conflict of interest.

Unless ERISA is amended to allow top hat plan participants to be free from ERISA's enforcement provisions, or amended to afford top hat plan participants the same protections as other benefit plan participants, top hat plan participants' retirement expectations will remain subject to events which can neither be controlled nor predicted by the participant.

Alternatively, the judiciary should uniformly utilize a *de novo* standard of review for top hat plan benefit denial claims, given the inherent conflict of the plan administrator in making benefit decisions. Such a mandate must come from the Supreme Court, and will have to be much more explicit than the Court's directive in *Firestone*, which served instead to divide the courts of appeals into three camps regarding application of the standard of review in conflicted administrator decisions.

So, do you put your top hat in, or put your top hat out? Or do you give it to the courts and let them shake discretion out? That's what it's all about . . .

