# *Microsoft* TAM— Answers Some Questions, Raises Others

A paradox faced daily by practitioners is that the so-called mechanical rules of the Code—simply aren't. When applied, an abundance of bright line tests and formulas fit as vaguely over the real world as some of the most generally written precepts. A good example of this phenomenon are the IRS's regulations governing discrimination in plan coverage and benefits. Despite the almost eighty pages of regulations dealing with nondiscrimination testing, the regulations only provide the appearance of control and precision.

What are the reasons for this conclusion?

A number of things force us to this conclusion. For one, the degree of detail and complexity make it difficult for practitioners and the IRS to fully comprehend and apply the regulations. For another, the tests are only as good as the data that can be obtained to run the tests. But the problem is not just a matter of complicated tests and imperfect data, and instead goes to the heart of the tests. The nondiscrimination tests in all their mathematical precision are only as good as the foundation upon which they are built, and the foundation is a shaky one.

The foundation that we refer to is the employer's workforce. The nondiscrimination tests are based on the number of a company's employees and the benefits provided these employees, and it is trying to figure out who is in the workforce that presents the biggest challenge to many plan sponsors. It never has been easy to distinguish between employees and independent contractors, and today's complicated working arrangements only make the problem worse. With leasing companies and professional employment organizations the lines are blurred as to which entity is the employer—the leasing company or the recipient of the services. The same problem is presented with controlled group entities that transfer individuals from one company to another and with transfers to and from joint venture entities. Determining who exercises command and control can be quite murky and theories of co-employment do not make matters any easier. Further, even when a company knows that someone qualifies as an employee, it is difficult to know when someone



© 2000 Aspen Publishers, Inc.

ceases to be one. It is not often easy to determine when someone ceases to provide "services" to an employer.

It is because of these uncertainties that qualified plan sponsors have judged it imperative to include fail-safe plan provisions to preclude controversy over the coverage of temporary workers such as Microsoft has encountered. As practitioners are aware, some IRS reviewers have been unwilling to approve plans with these sorts of protective provisions on the grounds that the provisions vested the employer with undue discretion. In a recently made-public (but still publicly unreleased) Technical Advice Memorandum (TAM), the IRS National Office upheld a plan provision designed to protect a plan against a claim for retroactive plan coverage that would result from a worker classification challenge.

## *IRS Technical Advice Memo*

The plan provision in the TAM was fairly standard. First, the plan guarded against a *Microsoft*-type problem. It did this by covering "employees," but then excluding (1) those who were not reported on the payroll records of the company as common law employees, and (2) those who were not treated as common law employees on their payroll records even if a court or other administrative agency determines that such individuals are common law employees and not independent contractors. The plan in question also contained a second coverage exclusion. This provision excluded employees who were covered by two payroll codes. One payroll code covered one group of rehired union employees who were on an inactive seniority list and the second payroll code covered workers who were hired to work on specific contracts and who were covered by a different retirement plan. The IRS district office challenged both of the participation exclusions and said that they vested the plan sponsor with undue discretion.

The National Office disagreed with the district office and concluded that both the anti-*Microsoft* provision and the payroll code-based exclusion were acceptable. The National Office seemed to be particularly sensitive to the *Microsoft* problem. No doubt based on the Service's own experience, the TAM acknowledged the difficulty of distinguishing between employees and independent contractors and noted that an employer has a "legitimate concern in protecting its plans from reclassification." The employer's concerns stem from the fact that a plan theoretically can be disqualified for covering an independent contractor. Without quite saying it, the National Office

appeared to endorse the employer's need to be conservative in judging the status of workers as independent contractors or employees and that it is understandable for employers to exclude those workers who have any significant chance of being construed as independent contractors.

The legal cornerstone for the Service's analysis is the "definite written plan" requirement of Code Section 401(a). The technical advice request dealt with a plan exclusion clause, but the National Office approached the issue by looking at the broader question of how both plan inclusion and exclusion provisions are drafted. The TAM concludes that not every coverage category is acceptable and that every coverage category must be analyzed to determine if it fails the definite written plan requirement because of improper employer discretion. The TAM is significant because it offers the most extensive guidance the Service has ever offered on the definite written plan requirement.

The first principle described in the TAM is a "business purpose" rule. According to the memo every coverage or exclusion category must be based on a legitimate business purpose. The TAM does not go into great detail describing the parameters of this requirement, and there might be a variety of provisions that were used which fail to meet this rule. One might be a plan provision excluding everyone in payroll code "M" and the payroll code was merely a surrogate for the employer's selective picking of workers to be excluded from the plan. Another example might be an inclusion or exclusion provision based on last names beginning with certain letters of the alphabet. This kind of provision might not embody the same kind of pick-and-choose concern, but its arbitrary design would make it difficult to ascribe a business purpose to the rule.

There are a number of uncertainties about the scope of the business purpose rule. For example, it is unclear whether it is a stand-alone requirement or it is a part of another requirement. The TAM gives as an example of an offending plan provision a plan providing a "list of employees" where (1) there is no business reason for the list *and* (2) a particular employee could be added to or removed from the list by the employer at any time. Did the plan have to fail both conditions to fail qualification or did it only have to fail one requirement? If the plan covers "all employees whose names begin with the letter A," does the provision fail because of the unlikely business justification or does it pass muster because the TAM sets forth two conditions and the employer does not retain the power to change an employee's name at will? Presumably, the business purpose test is a stand-alone requirement, but it is not entirely clear under the TAM.

There are other uncertainties about the business purpose rule. Does it apply to plan eligibility requirements only, or does it apply to plan provisions applying to specific benefits? For example, if a plan limits an early retirement sweetener to a subset of plan participants, does the eligible group have to be scrutinized for a business purpose? The TAM also offers little guidance on what constitutes good business reason for a classification. What if a plan only covers salesmen who satisfied a certain sales quota in the prior year? Is there a legitimate business purpose to limiting plan participation to the best performing employees? What if the plan limits coverage to workers whose names are picked out of a hat or to the first one hundred that apply for benefits? Is there a business purpose for these provisions?

The TAM confuses the matter further by setting forth a second legal principle, which is difficult to square with the business purpose rule. The TAM states that the test of whether a particular category is acceptable is whether it is clear to a participant and to a "reasonable person" whether a particular worker is covered or excluded. If fair notice is the test, then it should be all right for the plan to limit participation to those whose names begin with the letter A. But, as noted, it does not appear that the TAM would support such a provision because of the unlikely business justification for the rule.

The TAM's uncertain rationale raises questions about a number of fairly common coverage techniques. Plans frequently provide coverage or specified benefits only to employees enumerated on a list set forth in a plan appendix. This approach is commonly found in companies with extensive merger and acquisition histories. Are these provisions suspect if the covered group cannot be described in a single sentence? What about plans that offer coverage to all employees, but exclude from coverage any employee who has opted out of plan coverage? Case law confirms that employees can waive their ERISA rights and provides support for the notion that employers are free to contract with employees with respect to their benefits and exclude them from plan participation. (For example, *Smart v. Gillette Company Long-Term Disability Plan*, 70 F.3d 173 (1st Cir. 1995); *Finz v. Schlesinger*, 957 F.2d 78 (2d Cir.), certiorari denied, 506 U.S. 822 (1992). Indeed, this was the very heart of the issue in the case of *Capital Cities/ABC Inc. v. Ratcliff*, 1998 U.S. App. LEXIS 7565 (10th Cir. 1998). Here, the plan expressly excluded from plan participation "an individual who is hired by the company pursuant to an employment agreement or personal services agreement if such agreement provides that such individual shall not be eligible to participate in the Plan."

The Tenth Circuit in the *Capital Cities/ABC* case relied on this plan language and the agency agreements signed by the workers in concluding that the workers in question were not entitled to any plan benefits. Workers may desire to opt out, or negotiate out of, plan coverage for a number of reasons. These reasons may involve the desire to receive more current cash or, as we have seen in practice, the desire to avoid plan coverage for religious reasons. Are these kinds of plan exclusions problematic because the plan language leaves the business purpose of the exclusion uncertain?

## *Legal Basis*

Where the IRS finds legal support for the conclusion about business purpose for a plan exclusion is uncertain. Perhaps the Service believes the requirement is rooted in the classification test under Code Section 410(b). The regulations under that section provide that a coverage "classification" must be based on "reasonable business criteria" and that "enumeration by name" is not a reasonable classification. The classification test of Code Section 410(b) does not always apply, however, so if the business purpose requirement is a part of the more fundamental "definite written plan" requirement, why would the regulations under Code Section 410(b) describe this requirement only under the classification test and not also describe it as applying under the 70-percent coverage test of Code Section 410(b)? At best, it appears that there is no statutory basis for a "business purpose" limitation on a plan inclusion or exclusion provision. If it applies at all, it applies only under the classification test and, even there, the requirement may have a questionable legal basis.

The case law does support the TAM's notion that plan coverage provision must be sufficiently definite so that employees can determine their rights and seek enforcement in court. (*Engineered Timber Sales, Inc. v. Commissioner*, 74 T.C. 768, 823 (1980); *G&W Leach Co. v. Commissioner*, 41 TCM 988, 992 (1981).) There is also support for the notion that the plan document cannot give the plan sponsor the complete freedom to choose particular employees to be covered. (*South Texas Commercial Bank of Houston v. Commissioner*, 162 F.2d 462 (5th Cir. 1942); Rev. Rul. 74-466, 1974-2 C.B. 131.) It is a big jump in logic to conclude that these authorities, dealing with situations where the plan coverage provision was open-ended, also somehow outlaw perfectly objective plan provisions where it is not immediately clear why the employer made the coverage decision that it did.

The TAM also cites the ERISA Section 403 written plan requirement as a "corollary" to the definite written plan requirement of the Internal Revenue Code. The TAM's legal analysis, however, finds little support in the case law applying the "written plan" requirement of Title I of ERISA. Cases such as *Hamilton v. Air Jamaica*, 945 F.2d 74 (3d Cir. 1991), provide the most extreme example. Here, the Third Circuit—which is hardly a shrinking violet when it comes to fashioning participant rights under ERISA—held that a written ERISA covered severance plan could be drafted so as to provide for severance pay benefits on a case-by-case basis. In other words, the plan document in the *Hamilton* case provided that the plan sponsor could provide severance benefits if and when it decided to. The Third Circuit in *Hamilton* held that the written plan requirement of ERISA and the associated ERISA disclosure requirements are intended to allow participants to determine their rights under a plan, but that ERISA does not preclude case-by-case benefits as long as that feature of the plan is accurately described in the plan document. The participants in the *Hamilton* case knew exactly where they stood; it was just that they were not promised very much.

### *Conclusion*

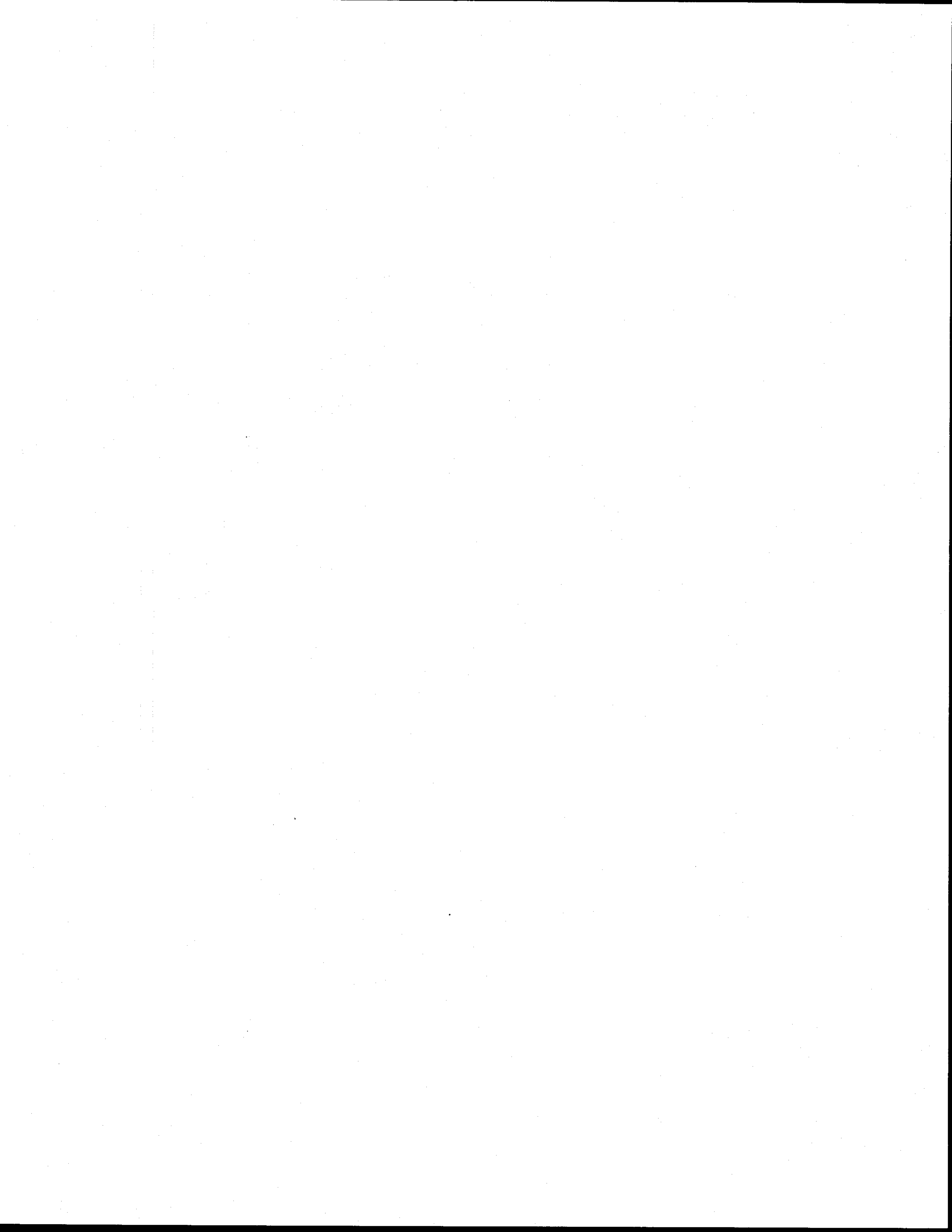
The TAM is welcome news for plan sponsors that have added a fail-safe plan provision to address potential employment classifications. The TAM also benefits independent contractors. Properly worded plan exclusions will eliminate the need for companies like Microsoft to engage in artificial employment practices to minimize the risk that independent contractors will be reclassified as employees for benefit plan purposes. For example, the press recently reported that Microsoft has decided to force temporary workers to engage in a mandated 100-day "break in service" after the workers have worked for 12 months. Companies like Microsoft might not be compelled to such extreme measures if they were confident in their plan provisions.

The Service's legal analysis is questionable and may leave other plan coverage provisions subject to doubt. Clearly, the problem of possible worker reclassification is a serious enough problem to warrant treatment in a more authoritative pronouncement than a technical advice memo. As the Third Circuit's recent decision dealing with a plant shutdown benefit indicates (*Bellas v. CBS, Inc.*, 221 F.3d 517 (3d Cir. 2000)), the courts do not give much deference to lesser-light

IRS authorities such as General Counsel Memorandums and technical advice memoranda. The Service needs to address the reclassification issue in a Revenue Ruling or regulation to ensure full judicial deference.

*Rosina B. Barker and Kevin P. O'Brien*
*Editors-in-Chief*
*Ivins, Phillips & Barker, Washington, DC*

**Editor's Note:** An article in the Autumn issue referred incorrectly to the effective date for the new cafeteria plan regulations concerning mid-year election changes. These take effect for plan years beginning on or after January 1, 2001, not 2002 as stated in the article.



# Selecting a "Select Group" Under a "Top-Hat" Plan—*Demery v. Extebank Deferred Compensation Plan*

*Joni L. Andrioff*

*The Second Circuit in* Demery *significantly expands the quantitative and qualitative standards applicable to the highly factual determination of whether a nonqualified retirement plan satisfies the definition of a "top-hat" plan under ERISA. Some caution is necessary, however, in applying these new standards.*

In many companies, management employees may be eligible to receive retirement benefits both from a tax-qualified plan that covers rank-and-file employees and from a nonqualified plan that covers an executive group. A nonqualified plan will be exempt from many of the requirements of ERISA,[1] provided that it is "a plan which is unfunded and is maintained by an employer primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees." This definition, commonly referred to as a "top-hat" plan, might easily be satisfied if the plan covers, for example, the top five highest officers in a corporation. In recent years, however, many employers have established nonqualified plans that allow middle management employees to make up contributions that may be cut off by the statutory limits that apply to 401(k) plans.[2] When the plan's coverage dips down below the top executive ranks, is it still a top-hat plan under ERISA?

Because many of the terms used in the top-hat plan definition have never been precisely defined, the answer is unclear, causing employers that maintain such plans to run the risk that ERISA will apply in its entirety. The recent case of *Demery v. Extebank Deferred Compensation Plan*, 216 F.3d 283 (2d Cir. 2000), will certainly help employers to establish that such a plan covering middle management employees is a top-hat plan, but some caution may still be required.

Joni L. Andrioff is a partner in the Chicago office of Jones, Day, Reavis & Pogue who practices in the area of employee benefits and executive compensation.



© 2000 Aspen Publishers, Inc.

## APPLICATION OF ERISA

Why do we care whether a plan is a top-hat plan under ERISA? The answer is that ERISA's participation, vesting, funding, and fiduciary responsibility rules do not apply to a "top-hat" plan. A top-hat plan is specifically excluded from coverage under each of the three sections of ERISA that contain these rules.[3] In other words, unlike a qualified plan,[4] participation in a top-hat plan is not subject to ERISA's minimum age and service requirements, and the benefit provided under the plan is not required to become vested based on the participant's service under a five-year "cliff" or seven-year graded vesting schedule. Further, the plan's assets are not required to be held in trust or funded at any minimum level. Additionally, "top-hat" plan "fiduciaries" are not required to act solely in the interests of plan participants and are not subject to ERISA's prohibited transaction rules.

ERISA's reporting and disclosure rules still apply to a top-hat plan, although its requirements are substantially abbreviated as compared to a qualified retirement plan. Moreover, top-hat plans are not exempt from ERISA's civil enforcement scheme. Accordingly, top-hat plan participants may bring claims for benefits under ERISA Section 502(a)(1)(B) and, presumably, actions for equitable relief under ERISA Section 502(a)(3). Common law actions are generally preempted with respect to top-hat plans, although participants may enforce their contractual rights under such a plan in actions under federal common law.

In the 25 years since the enactment of ERISA, the Department of Labor (DOL) has not issued any regulations clarifying or explaining whether a plan is "unfunded," or is maintained "primarily" for the purpose of providing deferred compensation, or what constitutes a "select group" or a "management or highly compensated" employee. Getting these terms right is extremely important to the employers that maintain top-hat plans. If the DOL determines on audit that a plan is not a top-hat plan, it could conclude that the plan should have been funded at the level required by ERISA and that the employees should have vested in their plan benefits under the relatively short five- and seven-year vesting schedules. Similarly, plan participants who challenge the employer's interpretation of these terms may be able to argue for such additional rights under Title I regarding the plan, such as ERISA Section 204(g)'s prohibitions on plan amendments that decrease accrued benefits under the plan. Both the DOL and plan participants could assert fiduciary breaches against

plan fiduciaries which fail to satisfy the requirements of being a top-hat plan.

## SEARCH FOR MEANING

In the absence of clarification in the statute or regulations, we look to ERISA's legislative history, DOL rulings, and case law for the meaning of the terms used to define a top-hat plan.

### *Legislative History*

The legislative history of the top-hat plan definition does not add much to its meaning. At the time of ERISA's passage, Congress did not articulate its reason for excluding top-hat plans from some of ERISA's protections. The Conference Committee reporting on ERISA's participation and vesting rules merely states that "unfunded plans of deferred compensation" are excluded from their provisions.[5] The report on the conference substitute regarding the minimum funding rules provides:

> The conference substitute excludes from the minimum funding rules of Title I unfunded plans maintained by the employer primarily to provide deferred compensation for select management or highly compensated employees (under Title II, such plans do not seek tax qualification). The conferees intend that this exemption is to include "consultant contracts" for retired management employees. . . . and plans adopted by a partnership exclusively for the benefit of partners pursuant to section 736 of the Internal Revenue Code.[6]

The report of the conference substitute establishing ERISA's fiduciary rules states that such rules:

> do not apply to an unfunded plan primarily devoted to providing deferred compensation for a select group of management or highly compensated employees. For example, if a "phantom stock" or "shadow stock" plan were to be established solely for the officers of a corporation, it would not be covered by the labor fiduciary rules. Also, a deferred compensation arrangement solely for retiring partners . . . is to be exempt from the fiduciary responsibility rules.[7]

Interestingly, earlier versions of the House and Senate bills that eventually culminated in the enactment of ERISA provide for an exclusion for "a select group of management employees," without

referring to any exclusion for highly compensated employees. The committee explanations of these earlier bills explain that the exclusion is intended to apply to plans for "top executives" or "key executives." These earlier versions of ERISA indicate that the original idea may have been to exclude plans covering only "key" or "top" executives, rather than middle management or other lower level executive positions.[8] Neither the final legislation nor its committee reports, however, make reference to any such intent.

### *DOL Advisory Opinions*

In its advisory opinions, the DOL has analyzed particular factual situations in determining whether a plan satisfies the definition of a "top-hat" plan. Earlier letters focused on the composition of the group eligible to participate in the plan. For example, in DOL Advisory Opinion 85-37 (Oct. 25, 1985), the plan provided to all employees "on the executive payroll" a retirement benefit under a final average pay formula, commencing at age 65, provided that the employee had at least ten years of service. The letter notes that the seven former employees receiving benefits under the plan had annual salaries ranging from $11,905 to $29,255, and included a cost accountant, a comptroller, three foremen, a scheduler (productions), and a time study position. The letter also noted that a past president and chairman of the board had received benefits under the plan. Further, the letter indicated that the 11 current employees covered by the plan included foremen, a superintendent, an assistant in the cost department, an order department clerk, an expediter, a stepmaster inventory control position, and an insurance position, among others.

At the time the plan was adopted, the executive payroll, which was originally created to cover managerial personnel, covered approximately 50 of the total 750 employees (or approximately 7 percent of the relevant workforce). The average pay for the executive group was $20,979, while the average pay for the ten highest paid hourly employees was $10,442. Based on these facts (and others), the DOL concluded without much analysis that the range of salaries and positions of the employees represented to be covered under the plan did not constitute a "select group of management or highly compensated employees" and accordingly was not a top-hat plan.

See also DOL Advisory Opinion 76-100 (Nov. 15, 1976) (plan covering supervisory personnel, executive staff personnel, department heads, and employees with three years' service is not a top-hat plan); DOL Advisory Opinion 75-64 (plan covering key executives

and managerial employees constituting fewer than 4 percent of active employees with average annual compensation of $28,000 compared to an average salary of $19,000 for all management employees is a top-hat plan); DOL Advisory Opinion 75-63 (July 22, 1975) (plan covering key employees who earn at least $18,200 and are "exempt" as administrative, supervisory, or professional employees is a top-hat plan); DOL Advisory Opinion 75-48 (Dec. 23, 1975) (plan continuing retirement benefits for 23 of 14,000 employees who are management employees with sales ranging from $19,286 to $67,992 is a top-hat plan). In contrast to these earlier letters, the DOL in DOL Advisory Opinion 90-41A (May 8, 1990) appears to take a different analytic tack. In analyzing whether a plan was "unfunded," the DOL stated, without reference to the statute or any legislative history:

> Sections 201(2), 301(a)(3), and 401(a)(1) provide an exclusion from the requirements of Parts 2, 3 and 4 of Title I (pertaining to participation, vesting, funding and fiduciary responsibilities, respectively) for "a plan which is unfunded and is maintained by an employer primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees" (commonly referred to as a "top-hat" plan). It is the view of the Department that in providing relief for "top-hat" plans from the broad remedial provisions of ERISA, Congress recognized that certain individuals, by virtue of their position or compensation level, have the ability to affect or substantially influence through negotiation or otherwise, the design and operation of their deferred compensation plan, taking into consideration any risks attendant thereto, and, therefore, would not need the substantive rights and protections of Title I . . . .
>
> It also is the Department's position that the term "primarily," as used in the phrase "primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees" in sections 201(2), 301(a)(3) and 401(a)(1), refers to the purpose of the plan (i.e., the benefits provided) and not the participant composition of the plan. Therefore, a plan which extends coverage beyond "a select group of management or highly compensated employees" would not constitute a "top-hat" plan for purposes of Parts 2, 3 and 4 of Title I of ERISA.

Subsequent DOL Advisory Opinions identify the ability of plan participants to negotiate their benefits as an important factor in determining whether an "unfunded" plan may be a top-hat plan. (See 1996 ERISA LEXIS 58 (Oct. 3, 1996); 1992 ERISA LEXIS 44 (Oct. 20, 1992); DOL Adv. Opinion 92-13 (May 19, 1992).) The DOL gives no

further insights, however, into how the ability to negotiate may be determined. Only top executives would ordinarily have this ability, so Advisory Opinion 90-41A represents a constriction of the group possible under the DOL's former quantitative tests. In fact, as evidence of the considerable evolution of the DOL's thinking regarding the definition of top-hat plans, the DOL has stated informally that its earlier Advisory Opinions are no longer valid, and that the DOL will not issue any further Advisory Opinions on the subject.[9] It is not expected that the DOL will issue regulations regarding the top-hat plan definition in the near future.

### *Cases*

Several courts have attempted to define the terms used in ERISA's top-hat plan definition. The earliest of these, *Belka v. Rowe*, 571 F. Supp. 1249 (D. Md. 1983), analyzed the composition of the covered group, concluding that the retirement plan at issue was a top-hat plan. In *Belka*, the plan covered about 1.6 percent of the workforce in 1972 and 4.6 percent by 1980, including salesmen, vice presidents, sales managers, and supervisors. The average salary of the covered individuals was more than $40,000 in 1972 and nearly $55,000 by 1980, compared to an average company-wide salary of $9,195 and $16,000 for such years, respectively.

The court found it "particularly important" that only seven of the 73 employees covered in 1978 made less than $35,000 annually, compared to the average company-wide salary of $13,000, and that those seven were all in management positions (order processing manager, assistant general manager, director of purchasing and personnel, assistant controller, fleet equipment manager, and assistant director of manufacturing). The court rejected the plaintiffs' argument that the covered salesmen were not management employees and that a number of the covered employees were not highly compensated, noting that the statute provides an exemption for plans which are "primarily" designed for those individuals who are either management or highly compensated, using the definition of "highly compensated employee" for plan qualification purposes under the Tax Code to define "highly compensated."[10]

Later cases reflect the DOL's emerging view that the participants' ability to negotiate the plan's terms is important in determining whether a plan is a top-hat plan. In *Gallione v. Flaherty*, 70 F.3d 724 (2d Cir. 1995), the Second Circuit affirmed the district court's grant of the employer's motion for summary judgment, holding that the

retirement plan at issue was a top-hat plan. The plan in *Gallione* provided a benefit based on a dollars-times-years of service formula to a union's full-time officers. The union members eventually voted to terminate the plan on the ground that it was a drain on union resources. After the vote, the union officers, including Gallione, asserted to the membership that they had already determined prior to the vote to terminate the plan. The membership thereafter voted Gallione and his faction out of office.

In reaching its conclusion that the plan was a top-hat plan, the court noted that, in the union's hierarchical management structure, only 22 of its 68 officers were entitled to participate in the plan. None of the full-time employees who were not officers were eligible, nor were any of the 41 part-time officers. The 22 eligible had primary responsibility for ongoing operations, for setting union policy, and for answering to the union's membership. In explaining the participants' federal common law right of action for breach of contract, the court noted that Congress had exempted top-hat plans from ERISA's vesting and funding requirements on the premise that the employer's top-level executives have sufficient influence within the institution to negotiate arrangements that protect against the diminution of their expected pensions. For this reason, the court concluded that the participants must have a right under federal common law for breach of contract to enforce such negotiated arrangements. In this regard, the court noted that Gallione was one of the officers who purported to have terminated the plan and, accordingly, was enough of a "top-hat" employee to have influenced its terms.

Further, in *Duggan v. Hobbs,* 99 F.3d 307 (9th Cir. 1996), the Ninth Circuit held that an agreement settling a dispute between an employer and Duggan, its top salesman, by providing for lifetime monthly payments of $1,056.88 after the salesman's retirement and other benefits in exchange for a waiver of claims against the employer constituted a top-hat plan. In reaching its conclusion, the court noted that Duggan was the only employee ever to receive retirement benefits from the employer, that he was one of approximately 23 full-time employees, and that his average salary of between $50,000 and $60,000 was significantly higher than the average employee salary of $12,000. The next highest paid employee earned only half of Duggan's compensation. The court also determined that Duggan had the bargaining power to negotiate the terms of the arrangement, observing that he had in fact hired an attorney for that purpose. Noting that the agreement covered benefits of a type other than deferred compensation, the court noted that the arrangement

provided "primarily" for deferred compensation benefits, and therefore satisfied the definition of a top-hat plan.[11]

Similarly, in *Carrabba v. Randalls Food Markets, Inc.*, 38 F. Supp. 2d 468 (N.D. Tex. 1999), the court concluded that the employer had failed to carry its burden of proving that its retirement plan was a top-hat plan. The plan, providing death and retirement benefits, apparently covered without exception all of the employer's management employees. According to the court,

> the court simply cannot find from the evidence that the [plan] was maintained by the [employer] "primarily . . . for a select group of management or highly compensated employees." The words "a select group of" must be given some meaning. Quite candidly, the court questions whether it can articulate the meaning of the words "a select group," as used in the statute. The furthest the court can go is to express the conclusion that it cannot find from the evidence that the participants of the [plan] were a select group out of the broader group of management employees or the broader group of highly compensated employees.
>
> Perhaps, as the Department of Labor and some of the court decisions have suggested, the "select group" test is whether the members of the group have positions with the employer of such influence that they can protect their retirement and deferred compensation expectations by direct negotiations with the employer. The evidence does not persuade the court that any significant number of the participants in the [plan] individually had bargaining power of that kind. Of course, as a group, to the extent that they could act cohesively, they undoubtedly could influence the design and operation of the [plan], but that would be true of any group of employees within a company.

The uncertainty underlying the court's holding is understandable, in light of the dearth of guidance on the definition of a top-hat plan under ERISA.

## DESCRIPTION OF *DEMERY*

The Second Circuit in *Demery* affirmed the district court's grant of summary judgment to the defendants,[12] holding that the district court had correctly determined as a matter of law that the Extebank Deferred Compensation Plan was a "top-hat" plan exempt from most of the substantive requirements of ERISA. In *Demery*, the plan sponsor, Extebank, actually maintained two plans of deferred compensation—Plan A and Plan B—which supplemented Extebank's regular pension plan. The plaintiffs were former participants in Plan B,

which was established in 1987 and offered to assistant vice-presidents, managers, and other senior officers of the bank.

Under the facts as presented in *Demery*, Plan B allowed participants to defer up to 25 percent of their annual salaries as contributions to the Plan in each of 1987, 1988, and 1989. Under Plan B, a participant who reached normal retirement age while employed became vested in a benefit equal to the amounts he contributed, plus interest at a rate of 20 percent, compounded annually. If the participant terminated employment prior to normal retirement age, the interest rate under Plan B was 10 percent, compounded annually. Extebank purchased insurance contracts on each participant, naming itself as beneficiary upon the participant's death, and held these insurance policies in an account called the Deferred Compensation Liability Account. The number of participants in Plan B hovered right around 20 out of a total workforce ranging from 222 to 196 during the three-year period.

In 1996, Extebank was acquired by North Fork Bank in a merger and, shortly before or after the merger, "all of the plaintiffs left Extebank" before reaching normal retirement age. From the defendants' briefs on appeal, it appears that four of the eight plaintiffs, including Demery, quit after the merger, while the others were fired. As a result, all of the plaintiffs, with one exception, received a benefit calculated at the 10-percent interest rate, rather than at the 20-percent rate. It appears that Extebank terminated Plan B incident to the merger, cashed in the insurance policies to pay out the benefits, and kept any excess return on the policies.

Two years after Extebank's merger, the plaintiffs sued, bringing a claim for benefits against Plan B and for fiduciary breach under ERISA against the Plan sponsor and Stephen Maroney. The plaintiffs also brought common law claims for estoppel, breach of common law fiduciary duties, breach of contract, and unjust enrichment. In their fiduciary breach claim, the plaintiffs contend that Extebank tried to pressure and mislead them into believing that its acquiror, North Fork Bank, intended to terminate their employment and Plan B, urging them to take an immediate lump sum payment and to sign a release, rather than risk getting nothing. While not discussed in *Demery,* the plaintiffs' brief alleges that Extebank, at Plan B's inception, loaned some or all of the plaintiffs' money at the prime rate so that they could participate in the Plan. According to the plaintiffs' brief, one of the plaintiffs realized a return of $9.13 after paying his outstanding loan balance and taxes, after being invested in the Plan for almost ten years.

Extebank moved to dismiss the complaint on the ground that Plan B was a top-hat plan not subject to the provisions of ERISA relevant to the plaintiffs' claims. The district court converted the motion to dismiss into a motion for summary judgment on the ground that Plan B was a top-hat plan. The plaintiffs cross-moved for partial summary judgment, arguing as a matter of law that Plan B was not a top-hat plan. In 1998, the district court granted the defendants' motion for summary judgment, determining that Plan B was a top-hat plan under ERISA, and further held that the plaintiffs' common law claims were preempted by ERISA. In an unpublished opinion, the district court dismissed the plaintiffs' complaint in its entirety. The plaintiffs appealed, alleging that (1) summary judgment was granted before the parties had engaged in discovery; (2) Plan B was not a top-hat plan, based on the composition of its participants; and (3) the district court erred in dismissing the plaintiffs' claim of a fiduciary breach.[13]

Addressing each of these allegations in turn, the Second Circuit first noted that the plaintiffs took a different position on appeal than they had in the court below. In the district court, the plaintiffs argued that Plan B was a top-hat plan as a matter of law, "'based solely on the facts concerning participation in the Plan in affidavits submitted by the Plaintiffs, exhibits annexed thereto, and applicable federal regulations, Department of Labor Opinion letters, and published and unpublished case law.'" By contrast, on appeal, the plaintiffs contended that "the relevant and material facts are sharply disputed" and asserting that the district court erred in granting summary judgment for the defendants before the parties engaged in discovery. The Second Circuit rejected this argument, noting that the plaintiffs had served no discovery requests, did not seek an order compelling discover, and did not delineate what additional discovery they wanted to pursue. Characterizing the plaintiffs' efforts at discovery as "anemic," the Second Circuit held that the district court did not abuse its discretion in granting summary judgment without further discovery.

The court next addressed whether Plan B satisfied the requirements of a top-hat plan, concluding as a matter of law that it did, based on the following factors:

1. *Unfunded Status.* The court determined that Extebank's purchase and maintenance of life insurance policies in a separate account did not cause Plan B to be "funded" within the meaning of ERISA Sections 201, 301, and 401. In so holding, it adopted the standard applied in *Miller v. Heller*, 915 F. Supp. 651, 660 (S.D.N.Y. 1996), requiring the

plaintiffs "to establish, through the plan documents, a legal right any greater than that of an unsecured creditor to a specific set of funds from which the employer is, under the terms of the plan, obligated to pay the deferred compensation." According to the court, Plan B provided by its express terms that the benefits would be payable solely from the general assets of the employer, and that participants would have no interest in any specific assets of Extebank under the Plan.[14] The court stated that the district court had correctly concluded that the Plan was unfunded as a matter of law because the revenues from the insurance policies purchased on the participating employees, "although deposited in a separate account, 'became part of the general assets of Extebank.'"

2. *"Select Group."* The Second Circuit concluded that, although a relatively large percentage of the workforce (here, 15.34 percent) was covered by Plan B, "all of the participants were selected officers of the bank, were in management positions and were highly compensated in comparison to bank employees at large." Accordingly, the court held that Plan B was a top-hat plan. In reaching its conclusion, the court took its cues from DOL Advisory Opinion 85-37A, stating that "there is no existing authority that establishes when a plan is too large to be deemed 'select,'" but further noted that the composition of the covered group may be just as important in determining whether a plan is a top-hat plan. With respect to Plan B, the court stated:

> [W]hile the [percentage] is probably at or near the upper limit of an acceptable size for a "select group," we cannot say that it alone made Plan B too broad to be a top hat plan without considering the positions held at the bank by the Plan's participants. It is clear from our prior decision in *Gallione* that a "select group of management" could include senior management and high-level executives.

Rejecting the plaintiffs' argument that a select group should include only key executives and highly compensated employees, the court stated that "while Plan B participants did include assistant vice-presidents and branch managers, and therefore swept more broadly than a narrow range of top executives, it was nonetheless limited to highly valued

managerial employees," rather than employees at varying levels.

Further, the court held that Plan B covered highly compensated employees within the meaning of ERISA's top-hat definition because the average salary of plan participants was more than double that of the average salary of all Extebank employees. The court went on to state that, even if "two or three" employees were arguably not "highly compensated" or "a select group of management," Plan B might still be defined as a top-hat plan because the statute defines a top-hat plan as "primarily" designed to provide deferred compensation to such groups, interpreting "primarily" to modify the participant composition of the Plan, rather than the benefits that it provides.

3. *Bargaining Power.* The court held that the ability to negotiate the terms of the plan is an "important component of top hat plans." According to the court, such plans are exempted from ERISA's substantive requirements because Congress deemed top-level management, unlike most employees, to be capable of protecting their own pension expectations, citing *Gallione.* Rather than examining any facts on the issue, however, the court noted that the record was silent as to the plaintiffs' ability to negotiate the terms of the Plan, and there is no evidence that they attempted to do so. The court concluded that the plaintiffs failed to proffer any direct or circumstantial evidence raising a question of fact as to whether the plaintiffs possessed sufficient bargaining power to influence the terms of Plan B. In so doing, the court was not persuaded by the fact that Plan B differed significantly from the "heavily negotiated" Plan A which covered Extebank's four top executives. The court also determined that the fact that Plan B participants had to borrow money even to participate in Plan B was no evidence that they were not highly compensated. It further concluded that the fact that Plan B was targeted at middle management rather than at the very top executives "shed little light on plaintiffs' bargaining power."

Having found that Plan B was a top-hat plan, the court made short work of the plaintiffs' common law claims for breach of contract and breach of common law fiduciary duties, noting that the

plaintiffs proffered no direct or circumstantial evidence sufficient to raise a genuine question of material fact with respect to such issues. In short, according to the court, the plaintiffs received the amounts to which they were entitled under the terms of the Plan. It stated that "the fact that the sums of money were lesser than anticipated, due to taxes or repayment of amounts borrowed, is of no moment."

## EXPANSION OF TOP-HAT PLAN DEFINITION

*Demery* significantly expands the range of nonqualified retirement plans that, as a matter of law, may satisfy the definition of a top-hat plan under ERISA. In so doing, the court resurrects the DOL's earlier quantitative tests, establishing some new standards for defining "a select group of management or highly compensated employees." Perhaps the court's most notable conclusion is that a plan covering a relatively high percentage of the workforce may be a "select" group. Although the court notes that the 15.34-percent mark achieved by Plan B "is probably at or near the upper limit of the acceptable size for a 'select group,'" the relatively high percentage did not cause Plan B to fail to be a top-hat plan. To date, this would appear to be the highest percentage of the workforce determined by a court or the DOL to be a "select" group for purposes of ERISA's top-hat definition. Accordingly, this benchmark should provide considerable leeway to plan sponsors in covering middle management employees under a top-hat plan.

Further, the court's definition of "highly compensated" employees does nothing to discourage the coverage of middle management employees under a top-hat plan. According to the court, the participants of Plan B could be considered as "highly compensated" because the average salary of Plan B's participants was double the average salary of all Extebank employees. It is likely that this numeric test could be manipulated to support a plan sponsor's argument that a plan covering middle management employees is a top-hat plan. On a cautionary note, however, it should be noted that the Second Circuit called the top-hat plan determination a "highly fact specific inquiry, analyzing quantitative and qualitative factors in conjunction." Accordingly, under facts slightly different from those in *Demery*, a court might reach a different result. For example, the plan in *Demery* covered about 20 participants, representing approximately 15 percent of the workforce. A court might reach a different result with respect to the plan of a large public company where 15 percent of the workforce represents thousands of employees. Similarly, in an

industry of minimum wage workers, a court may decline to define as "highly compensated" an employee whose salary is double the average salary of the employer's workforce at large.

If its expansive quantitative standards are not enough, the Second Circuit goes even further as an interpretive matter. The court noted that even if a plan covers a few non-management, non-highly compensated employees, it may still be a top-hat plan as long as the plan "primarily" covers "top-hat" employees. This interpretation of the word "primarily" as modifying the group of participants covered by the plan accords with the court's in *Belka*, but is directly contrary to the DOL's view in DOL Advisory Opinion 90-41A. In that Advisory Opinion, the DOL takes the position, without any real explanation, that the term "primarily" modifies the type of benefits provided under the plan, rather than the composition of its participants. The Second Circuit disagrees.

Additionally, the court defined a new qualitative standard for determining a "select" group by noting that each management employee covered by Plan B was "highly valued," if not highly placed, within the plan sponsor's management structure. Under this "highly valued" standard, the court noted that even branch managers and assistant vice presidents could be included in a "select group" of management employees. Presumably, this means that a plan is not a top-hat plan if it covers management employees who are not highly valued by the plan sponsor. The court, however, gave no indication of how this determination might be made or whether a plan covering all management employees would still be a top-hat plan, even if they are all highly valued in their own way. Accordingly, after *Demery*, it may be possible to establish a plan as a top-hat plan by documenting the highly subjective determination of how and why the plan sponsor values the covered employees.

While focusing on earlier quantitative tests and establishing new qualitative ones, the Second Circuit de-emphasizes the DOL's most recent view on what constitutes a top-hat plan as set forth in DOL Advisory Opinion 90-41A. While it declines even to cite the Advisory Opinion, the court makes note of its reasoning that "Congress deemed top-level management, unlike most employees, to be capable of protecting their own pension expectations." The court, however, does not actually apply this standard in *Demery*, noting instead that "the record is silent" as to the plaintiffs' ability to negotiate the terms of Plan B and "there is no evidence that they attempted to do so." It is tempting to conclude that the Second Circuit gave no weight to the plaintiffs' ability to negotiate in determining whether

Plan B is a top-hat plan. If it had explicitly rejected the DOL's view in Advisory Opinion 90-41A, *Demery* would have put this unworkable test to rest. Alternatively, the Second Circuit could have disposed of the test by framing it as an inference to be drawn from the other, more workable tests that it applied in *Demery*.

Given the procedural posture of *Demery*, however, the Second Circuit may have taken the plaintiffs' ability to negotiate as a fact because, on Extebank's motion for summary judgment, the plaintiffs failed to raise any genuine issue of material fact in this regard. In any event, the Second Circuit's limited inquiry into the plaintiffs' bargaining power seems to establish it as one of the factors that must be considered in determining whether the plan covered a "select" group. It is interesting to speculate about what facts a court might consider in determining whether plan participants have the ability to negotiate plan terms.

For example, as *Demery* makes clear, it is not enough for the plaintiffs to show that they did not actually engage in any negotiations relating to the terms of Plan B. Similarly, it is not enough to show that the employer maintained a separate Plan A for top management employees who, presumably, were able to negotiate terms different from Plan B. As illustrated by *Duggan* and *Gallione*, it should be enough if the plaintiffs show that they actually negotiated or influenced the terms of the Plan. Perhaps an employee who had previously negotiated an individual employment agreement with the employer would be held to have a similar ability to negotiate with respect to the plan, even if no such negotiation actually took place. Additionally, particular circumstances might demonstrate an employee's bargaining power, such as the employer's willingness to provide the employee with incentives to remain employed during a change in control or where the employer can show that the cost of replacing a particular employee would be very high.

In the absence of special circumstances, however, it is difficult to come up with a workable standard for determining whether an employee, other than very top management, has the ability to negotiate with respect to the terms of a nonqualified retirement plan. As a common sense matter, it is difficult to see how an individualized ability to negotiate may be shown with respect to 15 percent of the total workforce. Further, as the district court in *Randalls* pointed out, if collective bargaining counts, then the ability to negotiate is not limited to management or highly compensated employees.

It would be unfortunate if a court, presented with egregious facts, determined that plan participants lacked bargaining power on

the ground that they ultimately got a bad deal under the plan. The plan participants, if they have bargaining power, should be able to use it to negotiate for a speculative or risky arrangement that ultimately does not pan out, but this should not be taken as evidence that they lacked bargaining power. Still, at some point, a court could conclude that a deal is so one-sided as to outweigh all quantitative factors and to serve as evidence that the participants did not have the wherewithal to look after their own interests.

While the court did not so conclude in *Demery,* it is worth noting that the facts, as alleged by the plaintiffs, were never fully developed. According to the plaintiffs' brief on appeal, their grievance centers around the loan program that Extebank established in conjunction with its establishment of Plan B late in 1987. According to Extebank, it offered loans to Plan B participants because the Plan was established so late in the year that the participants were unlikely to be able to come up with the money themselves. The loan program, which was apparently continued during 1988 and 1989, extended loans at the prime rate. While not at all discussed in *Demery*, this arrangement bears some examination.

Let's assume for a moment that the plaintiffs borrowed money from Extebank at the prime rate for the purpose of participating in Plan B. It seems self-evident that borrowing a large sum of money (25 percent of annual compensation) at the prime rate for ten or more years in order to defer the same amount to achieve a return of 10 percent compounded annually is not a very good deal. This is borne out by the fact, alleged in the plaintiffs' brief, that one of the plaintiffs came out only $9.13 ahead after paying his outstanding loan balance and taxes, despite being invested in the Plan for almost ten years. The only way that this borrowing arrangement makes any sense is if the employee expected to pay off the loan almost immediately by, for example, using a scheduled bonus. In fact, the longer the duration of the loan, the less sense the arrangement makes.

Taking all of these factors into account, each plaintiff should have been able to do the math to determine whether making the maximum deferral of 25 percent of salary to achieve a possible 10-percent return while, at the same time, borrowing the same amount at the prime rate was a good idea. What happened? Because the facts of the case have not been developed, it is unclear whether the plaintiffs were misinformed about the terms of the arrangement and expected a 20-percent return even if they terminated prior to normal retirement age. Alternatively, the plaintiffs may have been adequately informed about the arrangement, but simply failed to

properly evaluate the risk of terminating employment prior to normal retirement age and the effect of failing to promptly pay off their loans.

## POSSIBLE RECOVERIES

If the plaintiffs had prevailed in arguing that Plan B was not a top-hat plan, would ERISA have given them a recovery? The dearth of facts makes this difficult to determine. If the document comprising Plan B really provided for a 10-percent return upon a termination of employment prior to normal retirement age, then the plaintiffs' claim for benefits would not have yielded them anything more; they would have already received what they were entitled to under the Plan. In that event, it is questionable whether the application of ERISA's participation, vesting, or funding rules would have done much for the plaintiffs. Further, even if Extebank violated ERISA's reporting and disclosure rules regarding Plan B by not producing a summary plan description, for example, it is unlikely that the court would have awarded the plaintiffs with damages equal to their losses.

Under ERISA, however, the plaintiffs could have claimed that Extebank breached its fiduciary duties with respect to the Plan. This might be the case, for example, if Extebank failed to disclose some essential term of the arrangement to the plaintiffs and thereby interfered with their choices regarding the arrangement. Even if Extebank did provide the plaintiffs with the information that they needed to determine whether to contribute to the Plan, the plaintiffs might have been able to argue that Extebank had a fiduciary duty to disclose to Plan B participants that they would lose out if they borrowed money to participate in the Plan and failed to repay the loan promptly prior to a termination of employment occurring before normal retirement age. In other words, while the loans were not a bad idea for everyone in every case, Extebank should have told each plaintiff that borrowing for any length of time might be a bad idea for him or her. The duty of a fiduciary under ERISA to provide such particularized advice is a matter of much debate among the courts[15] and in Congress and exceeds the scope of this article. Even if the plaintiffs had prevailed on a claim for fiduciary breach, however, it is difficult to determine how the court would have measured their recovery.

Interestingly, even though Plan B is a top-hat plan, as the Second Circuit has determined it is, the plaintiffs may still enforce their rights under ERISA's civil enforcement scheme. The courts have held that the plaintiffs have a federal common law right of action to enforce the contract rights that they were theoretically able to negotiate with

respect to the Plan and that the principles of unilateral contract theory apply. In this regard, if the facts support the plaintiffs' allegation that the Plan was illegally terminated or if it were illegally amended, the plaintiffs may be able to enforce their contractual rights under the Plan as it existed prior to the illegal termination or amendment.[16] Further, the plaintiffs may be able to bring an action for equitable relief under ERISA Section 502(a)(3) to enforce the terms of the plan. Such equitable relief may take the form of requiring Extebank to disgorge the amount of the interest it collected on the loans it made to participants. Still, the plaintiffs would have to show that the loans somehow violated the terms of ERISA or Plan B. Depending on the development of the facts in the case, however, a court might decide that the plaintiffs simply made a poor choice in deciding how and for how long to participate in Plan B.

## NOTES

1. "ERISA" refers to the Employee Retirement Income Security Act of 1974, as amended, which is codified at 29 U.S.C. 1101 *et seq.*

2. The Internal Revenue Code of 1986, as amended ("Code"), imposes limits on the amount which participants may elect to defer under a qualified profit sharing plan with a cash or deferred arrangement under Code Section 401(k). The annual limit on such amounts under Code Section 402(g) is $10,500 (in 2000, as adjusted). Such deferrals and any matching contributions may be further limited by the Code's nondiscrimination tests under Sections 401(k)(3) and 401(m) for "highly compensated employees," which are defined under Code Section 414(q), as relevant here, as employees with annual compensation of at least $80,000 (in 2000, as adjusted). Additionally, Code Section 401(a)(17) provides that the maximum amount of annual compensation that may be taken into account under any qualified plan is $170,000 (in 2000, as adjusted). A nonqualified plan intended to make up amounts cut off by the maximum annual limitations of Code Section 415 is defined under ERISA Section 3(36) as an "excess benefit plan" and is subject to different rules than top-hat plans.

3. The distinction between a qualified and nonqualified plan is determined under the relevant Code provisions which also comprise Title II of ERISA. A qualified plan which satisfies the requirements of Code Section 401(a), including its participation, coverage, vesting, and funding requirements, allows participants to defer taxation on their benefits until receipt, even if such benefits are both vested in the participant and funded by a trust. If a plan is "nonqualified" because it does not satisfy Code Section 401(a), its participants may still avoid current taxation on their benefits if the plan satisfies the rules of Code Section 83. Under these rules, a benefit which is both vested and funded would be currently taxable to the participants. A benefit which is "unfunded" or, if funded, is subject to a substantial risk of forfeiture will not be currently taxable under Code Section 83. Even if a nonqualified retirement plan is not required to satisfy the requirements of Code Section 401(a) to achieve a favorable tax result, the plan may continue to be subject to ERISA's participation, vesting, and funding

requirements which parallel many of the provisions of Code Section 401(a), unless, as explained above, the plan is a top-hat plan.

4. ERISA §§201(2), 301(a)(3), and 401(a)(1).

5. Conference Committee Explanation (P.L. 93-406), (CCH) Pens. Plan Guide (1990), ¶14,410.10.

6. Conference Committee Explanation (P.L. 93-406), (CCH) Pens. Plan Guide (1990), ¶14,610.10.

7. Conference Committee Explanation (P.L. 93-406), (CCH) Pens. Plan Guide (1990), ¶14,710.10.

8. For an excellent summary of the legislative history of ERISA's top-hat plan provisions, see Amoroso, Yurkovic and Pope, "SERP Sponsors Beware," *BNA Pension & Benefits Reporter*, Vol. 24, No. 16, p. 1001 (Apr. 21, 1997).

9. 27 *Tax Mgmt. Comp. Plan. J.* 198 (July 2, 1999).

10. See also *Simpson v. Ernst & Young*, 879 F. Supp. 802 (S.D. Ohio 1994) (no top-hat plan where non-managerial CPAs serving audit function were covered; no average salary information), affirmed, 100 F.3d 463 (6th Cir. 1996); *Darden v. Nationwide Mut. Ins. Co.*, 796 F. 2d 701 (4th Cir. 1986); *Darden v. Nationwide Mut. Ins. Co.*, 717 F. Supp. 388 (E.D.N.C. 1989), affirmed, 922 F.2d 203 (4th Cir. 1991), rev'd on other grounds, 503 U.S. 318 (1992) (no "select group" existed where the plan covered 18.4 percent of the workforce; plan is not a top-hat plan); *Pane v. RCA Corp.*, 868 F.2d 631 (3d Cir. 1989) (plan covers a "select group" where less than 1/10 of 1 percent of the workforce covered).

11. See also *Virta v. DeSantis Enterprises, Inc.*, 94-CV-1378 (FJS) (N.D.N.Y. 1996) (plan covering a woodworker and bookkeeper was not a top-hat plan, noting that the purpose of exemptions from ERISA is to allow management and highly compensated employees to bargain for advantageous plan provisions, while other employees need ERISA's protections); *Starr v. JCI Data Processing* Inc., 757 F. Supp. 390 (D.C.N.J. 1991) (plan was not a top-hat plan where participation was predicated on employment with a former employer).

12. The defendants were Extebank Deferred Compensation Plan B; Banco Exterior de Espana, Stephen V. Maroney; and North Fork Bank, as successor-in-interest of Extebank. Banco Exterior de Espana, the corporate parent of Extebank, sold Extebank to North Fork Bank in a merger in 1996. As president, Stephen Maroney was the president of Extebank and resigned following the merger. He was charged with determining which employees were eligible to participate in Plan B.

13. The plaintiffs also alleged that Extebank violated ERISA's reporting and disclosure requirements.

14. The court quoted Section 13 of Plan B, which stated:

> The Employer's obligation to make payments to any person under this Agreement is contractual and . . . the parties do not intend that the amounts payable hereunder be held by the Employer in trust or as a segregated fund for the Employee . . . . The benefits provided under this Agreement shall be payable solely from the general assets of the Employer, and neither the Employee, the Beneficiary, nor any other person entitled to payments . . .

shall have any interest in any specific assets of the Employer by virtue of this Agreement. Employer's obligation under the plan shall be that of an unfunded and unsecured promise of Employer to pay money in the future.

15. See, e.g., *Farr v. U.S. West Management Pension Plan*, 151 F.3d 908 (9th Cir. 1998) (employer breached its fiduciary duty during an early retirement window by failing to disclose to a number of affected participants that, due to an exception applicable only to them, the entire amount of their lump sum distributions could not be rolled over, resulting in unexpected adverse tax consequences).

16. See *Carr v. First Nationwide Bank*, 816 F.Supp. 1476 (N.D.Cal. 1993) (under unilateral contract theory, an amendment affecting employee deferrals or interest could be effective only with respect to deferrals after the amendment's effective date); *Kemmerer v. ICI Americas, Inc.*, 70 F.3d 281 (3d Cir. 1995) (plan termination was illegal where the plan did not contain a termination provision); *In Re: New Valley Corp.*, 89 F.3d 143 (3d Cir. 1996) (where the plan did not unambiguously reserve the right to terminate, extrinsic evidence may establish that participants became vested by performing services).