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Subject: **Plan Qualifies as a Top-Hat Plan Under ERISA**

Major References: ***Alexander v. Brigham and Women's Physicians Organization, Inc., __ F.3d __ (1st Cir. 2008 Case No. 07-1443***

Prior AALU Washington Reports: *08-14*

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In contrast to the U.S. District Court decision in Daft v. Advest, Inc. (see our Bulletin No. 08-14 earlier this month), the First Circuit Court of Appeals, in Alexander v. Brigham and Women's Physicians Organization, Inc., __F.3d. __ (1st Cir. 2008 Case No. 07-1443), more recently decided that an employer's deferred compensation plan constituted a top-hat plan under ERISA. The reasoning in the Court of Appeals case differs significantly from the District Court's reasoning in Advest.

Alexander v. Brigham and Women's Physicians Organization, Inc. involved plans set up by the employer for its physicians who were affiliated with the Harvard Medical School faculty. The physicians had relatively low salaries (in comparison to market generated earning capacity) which were imposed on them by the school. To deal with this problem and respond to the earnings needs of the physicians, the employer hospital established two deferred compensation plans that were designed to receive "excess" earnings based on the "net practice income" produced by each physician. If that income was positive (i.e., the income produced exceeded allocated expenses) such positive amount (up to 25% of salary) was credited to the first deferred compensation plan. Half of any additional net practice income was allocated to the second deferred compensation plan and the balance went to the employer.

A physician's account in these plans was reduced if his net practice income was negative (allocated expenses in excess of net practice income). This negative adjustment apparently triggered the law suit,

i.e., a former employee/physician sued, alleging that these deferred compensation plans violated ERISA's vesting and fiduciary requirements. The employer countered that the plans in question were top-hat plans and therefore not subject to those requirements. The trial court agreed and the issue was appealed to the First Circuit.

The Court of Appeals addressed two issues in ultimately determining that the plans were indeed top-hat plans.

The first issue was whether the plans "catered to more than a select group of highly compensated employees." In analyzing this issue, the court focused on the same type of percentage tests that were also the focus of ***Advest***. In this case, however, the court noted that, while the group of physicians potentially eligible for the plans ranged from approximately 27% to 32% of the workforce, the actual percentage of physicians participating (i.e., with account balances) in the plans was much lower -- in the 3%-9% range.

In ***Advest***, the coverage percentage was either 15% (the percentage used by the court) or 12.78% (the percentage argued by the defendant). The ***Advest*** court analyzed top-hat cases in both the Second and Sixth Circuits, noting that 15% is "at or near the highest percentage a 'top hat' plan could be" in the Second Circuit, while other courts, including those in the Sixth Circuit (the circuit in which the district court in ***Advest*** resided), have applied both qualitative and quantitative factors in their analysis, with coverage rates between 10% and 15% qualifying as top-hat plans. The court stated, however, that covered rates alone do not establish a top-hat plan. (Please note: the foregoing discussion should be viewed as a clarification of our earlier discussion in Bulletin No. 08-14 of the precedents applicable in analyzing the importance of the percentage test for top hat plans).

The court also pointed to the average compensation of the plan participants, which was substantially higher than the average for other employees. The average compensation of the overall employee workforce was in the $74,000-$83,000 range, whereas the contributors to the plan were well above $400,000 in compensation. In contrast, the use of average employee compensation for purposes of analyzing whether a plan constitutes a top-hat plan was a factor that was rejected in ***Advest***.

The plaintiff in ***Alexander*** argued that, by using the lower employee percentage comparison, the court was not appropriately applying the top-hat standard. He relied heavily on the definition of "participant" as used in ERISA and as used in the forms that were executed by the physicians. The court, however, rejected his argument that all of the physicians were participants, even if they had not actually accrued any account balance under the deferred compensation plans.

The second relevant issue addressed bargaining power. The ERISA statute does not mention that factor.. However, the Labor Department made bargaining power an issue in an opinion letter (Opinion 90-14A) approximately 17 years ago. It suggested that individuals, who do not need the protections of ERISA and therefore could have top-hat plans, are those that could substantially influence, through negotiation or otherwise, the design and operation of their deferred compensation plans.

The Court of Appeals here took the position that, although bargaining power was not an express requirement for a top hat plan, it was a "gloss" on the interpretation of the statute. The court, however, did indicate that individual bargaining power is not a requirement, but that group bargaining power is essential so long as the group as a whole has that bargaining power. This is consistent with the approach taken in ***Advest***. (It is interesting to note that, under this rationale, broader coverage would presumably provide greater bargaining power -- a conclusion which generally appears to run contrary to the select group notion).

This decision again highlights the fact-intensive nature of the top-hat plan criteria. Because the Labor Department has never provided any definitive guidance and is not likely to do so, employers are left to take their chances in designing plans. Therefore, as a practical matter the legal risks in designing a top-hat plan come not from the Labor Department but from a multiplicity of civil suits by disgruntled employees. In effect, employers are put on notice to be especially careful in designing these plans. The risks may come from many and often unanticipated directions.

Any AALU member who wishes to obtain a copy of ***Alexander v. Brigham and Women's Physicians Organization, Inc.*** may do so through the following means: (1) use hyperlink above next to "Major References," (2) log onto the AALU website at www.aalu.org and enter the *Member Portal* and select *Current Washington Report* for linkage to source material or (3) email Erik Ruselowski at ruselowski@aalu.org and include a reference to this *Washington Report*.

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