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View From McDermott: Conflicting Review Standards in Executive Retirement Plan Benefit Claims—Is There Really a Difference?

By Michael T. Graham

Under the Employee Retirement Income Security Act, retirement plans generally come in two flavors – (i) retirement plans qualified under Section 401 of the Internal Revenue Code (the Code) and (ii) executive retirement plans, called ''top hat'' plans, which aren't Code-qualified. What does that mean? While qualified retirement plans are subject to all of ERISA's funding, participation and fiduciary provisions, top hat plans aren't and may offer benefits exceeding those allowed under Code-qualified plans. Simply put, top hat plans are unique animals under ERISA.

ERISA defines a top hat plan as one ''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.''[1] ERISA treats top hat plans differently in several ways. First, ERISA explicitly exempts top hat plans from its fiduciary requirements.[2] In addition, ERISA doesn't require top hat plans to satisfy participation, funding and vesting requirements that are applicable to other ERISA-governed retirement plans.[3] Moreover, the Department of Labor allows top hat plans an exemption from disclosure requirements.[4] So, in essence, top hat plans are only subject to ERISA's civil enforcement remedies and administrative claims procedures.[5] As a result, ERISA affords top hat plan participants and beneficiaries their sole remedies for recovering benefits or enforcing plan terms.[6] Put another way, while top hat plan participants may not sue for breaches of fiduciary duty or illegal benefit cutbacks under ERISA, they may challenge benefit determinations, but must do so only under ERISA Section 502(a)(1)(B) and only after exhausting their administrative claim remedies.[7]

Litigation involving top hat plans isn't plentiful—likely due to the fact that such plans are available only to a small number of highly paid executives. However, within the limited top hat litigation realm, there exists a conflict among the federal courts of appeals over a seminal question—what review standard is to be applied to a benefit determination? While the U.S. Su-

[1] *See* 29 U.S.C. § 1051(2).

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[2] *See* 29 U.S.C. § 1101(a).

[3] *See* 29 U.S.C. § 1083(a)(3) (exemption from minimum funding standards); 29 U.S.C. § 1051(2) (exemption from participation and vesting requirements).

[4] *See* 29 C.F.R. § 2520.104-23.

[5] *See* 29 U.S.C. §§ 1021, 1132, 1133.

[6] See 29 U.S.C. § 1132(a)(1)(B); *Great-W. Life & Annuity Ins. Co. v. Knudson*, 534 U.S. 204, 209, 27 EBC 1065 (2002) (expressing reluctance to ''extend[] remedies not specifically authorized by [ERISA's] text'') (6 PBD, 1/9/02;29 BPR 217, 1/15/02); *Mertens v. Hewitt Assocs.*, 508 U.S. 248, 254, 16 EBC 2169 (1993) (noting that ERISA's ''carefully crafted and detailed enforcement scheme provides 'strong evidence that Congress did not intend to authorize other remedies that it simply forgot to incorporate expressly' '').

[7] *In re New Valley Corp.*, 89 F.3d 143, 153, 20 EBC 1537 (3d Cir. 1996) (because top hat plans are exempt from ERISA's fiduciary requirements, there is no ERISA-based cause of action for a fiduciary breach under a top hat plan); *Miller v. Eichleay Eng'g, Inc.*, 886 F.2d 30, 34 n.8 (3d Cir. 1989) (because top hat plans are exempt from ERISA's substantive participation and vesting rules, ERISA's anti-cutback provision isn't applicable to top hat plans).

preme Court has definitively answered this question for most ERISA plans in *Firestone Tire & Rubber Co. v. Bruch*,[8] the unique nature of top hat plans has resulted in conflicting rules among the circuits. Whether these conflicting standards elicit similar results is an open and complex question for most ERISA practitioners.

Typical Standard of Review in ERISA Benefit Cases

The standard of review applied in a lawsuit is, many times, a case determinative decision by the court. For instance, in a criminal case, the prosecution has a very high burden to prove guilt beyond a reasonable doubt. In civil cases, if the review standard is *de novo*, then the party that offers sufficient evidence to prove their claims is victorious. And, in cases where the court reviews a claim on an abuse of discretion or arbitrary and capricious standard, the plaintiff bears the high burden to prove a defendant's position is objectively unreasonable.

In 1989, the Supreme Court in *Firestone* set forth the prevailing rule for determining the review standard to be applied in ERISA benefit cases. In *Firestone*, the court, drawing from trust law principles, held that a *de novo* review standard should be applied to a plan's benefit determination, under which the court should grant no deference to the plan's decision. However, when a plan grants the plan administrator discretionary authority to interpret and construe its terms, the appropriate review standard is that the benefit determination will be upheld so long as it isn't arbitrary or capricious.[9]

Since 1989, the *Firestone* test has been applied across myriad ERISA-governed plans with one exception—top hat plans. Since top hat plans are ''odd ducks'' under ERISA, the circuits of the U.S. Courts of Appeals have taken very divergent views towards whether *Firestone* applies to top hat plan benefit determinations. This circuit split is made odder by the circuits that have been grouped together. For example, the Seventh Circuit (typically employer friendly) joins with the Ninth Circuit (typically plaintiff friendly) in applying *Firestone*, while the Third Circuit (typically plaintiff friendly) joins with the Eighth Circuit (typically employer friendly) in creating exceptions to the *Firestone* rule.

There are two fundamental questions presented by this circuit split—does it really matter what standard is applied and does each test reach the same ultimate result?

Applying *Firestone* in Top Hat Context

One of the first cases to address the appropriate review standard to apply to top hat plans arose in the Seventh Circuit in *Olander v. Bucyrus-Erie Co.*[10] In *Olander*, a corporate officer challenged a supplemental pension plan's decision with respect to the type of compensation that was to be included in the benefit calculation.

On appeal, the parties disputed the appropriate standard of review to apply. The plaintiff contended that the top hat plan was really an excess benefit plan, which ERISA doesn't govern and, therefore, a contractual *de novo* standard should be applied. The employer countered by arguing that the top hat plan qualified as an ERISA plan and, therefore, the prevailing *Firestone* arbitrary and capricious standard should apply. The Seventh Circuit first determined that the plan at issue qualified as an ERISA top hat plan.[11] The plaintiff then argued that because the plan document was silent as to discretion related to the plan administrator's calculation of benefits, a *de novo* standard should be applied. However, the court disagreed, finding that the top hat plan expressly gave the plan administrator discretion over benefit distribution, even if it was silent specifically on benefit calculation. Given this discretion, the court applied the arbitrary and capricious standard.[12]

Following *Olander*, other circuits have followed suit and applied *Firestone* deference to top hat plan claims. In 2008, the Second Circuit applied *Firestone* in *Paneccasio v. Unisource Worldwide, Inc.*[13] In *Paneccasio*, the plaintiff argued that his top hat plan was improperly terminated and, therefore, he should receive the benefits he was promised under the plan. While the Second Circuit noted that top hat plans were exempt from many of ERISA's substantive provisions, they were subject to ERISA's civil enforcement rules.[14] Because ERISA benefits were at issue, the court found that *Firestone*'s arbitrary and capricious review standard applied because the plan's termination provisions granted the employer discretion to terminate the plan at any time.[15]

As noted above, even the typically plaintiff-friendly Ninth Circuit has followed *Olander* and applied *Firestone*'s deferential standard. In *Sznewajs v. U.S. Bancorp Amended and Restated Supp. Benefits Plan*,[16] a beneficiary challenged a top hat plan's determination as to the proper beneficiary of a deceased participant's account. The plaintiff argued that because a top hat plan was involved, which was exempt from ERISA's fiduciary provisions, the plan's determination should be *de novo* rather than under a deferential standard. The Ninth Circuit noted that several courts had carved out exceptions to the *Firestone* test for top hat plans despite discretion-granting provisions in the plan. However, the court determined that no case law existed to suggest that applying a different standard of review would lead to a materially different result on the claim. Accordingly, the court applied *Firestone*'s standard because

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[8] *Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101, 115, 10 EBC 1873 (1989).

[9] *Id.* In *Metropo. Life Ins. Co. v. Glenn*, the court later added to this test, finding that under the arbitrary and capricious standard, any conflict of interest on the part of the plan administrator must be included as a factor in deciding whether the plan administrator has made an unreasonable determination. 554 U.S. 105, 115, 43 EBC 2921 (2008); (119 PBD, 6/20/08; 35 BPR 1501, 6/24/08).

[10] *Olander v. Bucyrus-Erie Co.*, 187 F.3d 599, 23 EBC 1369 (7th Cir. 1999) (26 BPR 1955, 8/2/99); *see also Comrie v. IPSCO, Inc.*, 636 F.3d 839, 842, 50 EBC 2473 (7th Cir. 2011) (upholding *Olander*'s application of *Firestone* deference for a top hat plan).

[11] 187 F.3d at 606.

[12] *Id.* at 607.

[13] *Paneccasio v. Unisource Worldwide, Inc.*, 532 F.3d 101, 44 EBC 1297 (2d Cir. 2008) (130 PBD, 7/8/08; 35 BPR 1667, 7/15/08).

[14] *Id.* at 108.

[15] *Id.*

[16] *Sznewajs v. U.S. Bancorp Amended and Restated Supp. Benefits Plan*, 572 F.3d 727, 47 EBC 1315 (9th Cir. 2009) (132 PBD, 7/14/09;36 BPR 1713, 7/21/09).

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carving out an exception for top hat plans would create unnecessary confusion under ERISA.[17]

Exceptions to *Firestone* Rule for Top Hat Plans

In 1991, the Third Circuit became the first court affirmatively to find that the *Firestone* standard shouldn't apply to top hat plans. In *Goldstein v. Johnson & Johnson*,[18] the Third Circuit created an exception to *Firestone*, finding that a *de novo* standard is more appropriate for these unique plans. The *Goldstein* court first acknowledged that the *Firestone* standard was born out of trust law and that decisions by trust fiduciaries clothed with discretionary authority are typically entitled to deference. However, the court then noted that top hat plans aren't subject to any of ERISA's substantive provisions, including its fiduciary provisions.[19] Given that top hat plan administrators don't have ERISA-derived fiduciary duties, the court determined that *Firestone* was inapplicable to top hat plans.[20] Since top hat plan administrators have no fiduciary responsibilities, the court held that top hats are more analogous to the types of plans under *Firestone* that receive no deference.[21]

However, the *Goldstein* court didn't stop there. The court acknowledged that its finding could appear to create anomalous results between different types of ERISA plans, as different review standards on the same issue may result in different interpretations of a single plan's terms. The court also noted that this potential conflict may not be as severe as it appears, as it would occur only when the top hat plan and the other ERISA plan at issue each have explicitly granted discretion to the plan administrators. The court determined that in the case of a top hat plan, even though the administrator may not receive *Firestone* ''deference,'' any grant of discretion must be read as part of the unilateral contract that makes up the top hat plan—as a contractual term, the discretionary powers must be given effect as ordinary contract principles.[22] The court found that ordinary contract principles require that, where one party is granted discretion under the contract's terms, the discretion must be exercised in good faith—a requirement that includes exercising that discretion without defeating the benefit of the bargain created by the parties. Accordingly, the court held that under a top hat plan, if the plan's terms grant an administrator discretion to interpret or construe the plan, then a benefit decision will be reviewed *de novo*, but also that the covenant of good faith and fair dealing under contract law must also be applied to the decision's review.[23] The court explained that applying the covenant of good faith and fair dealing would lessen the conflicting results that could occur by not applying *Firestone*.[24]

The *Goldstein* ''exception'' to the *Firestone* standard has also been adopted by the Eighth Circuit, but with a slight twist. In *Craig v. Pillsbury Non-Qualified Pension Plan*,[25] a plaintiff challenged a top hat plan's benefit determination that certain retention bonuses weren't to be included in his plan compensation. Addressing the appropriate review standard, the Eighth Circuit adopted the view from *Goldstein* that *Firestone* deference isn't appropriate in top hat plan cases because top hat plans are exempt from ERISA's fiduciary protections.[26] The Eighth Circuit even adopted *Goldstein*'s rule that a grant of discretion in a top hat plan must be read as part of the unilateral contract that makes up the top hat plan, and where discretion is granted under the top hat plan, that discretion must be exercised in good faith.[27] However, the Eighth Circuit didn't necessarily adopt the covenant of good faith and fair dealing from contract law for the ''good faith'' assessment. Instead, the court held that ''we must determine whether the Plan's decision was reasonable.''[28]

The *Goldstein* and *Craig* ''exceptions'' to *Firestone* deference haven't gone unchallenged. In a recent decision from the Seventh Circuit, Judge Frank H. Easterbrook severely criticized the Third and Eighth Circuits' decisions not to apply the *Firestone* standard to top hat plans. In *Comrie v. IPSCO, Inc.*, a plaintiff challenged a plan administrator's decision not to include a bonus amount in his top hat plan compensation level.[29] Addressing the appropriate review standard, the court tackled the *Goldstein* and *Craig* decisions and declared that ''[w]e don't get it.'' The court stated:

> When the Supreme Court held in *Firestone* that judges presumptively make independent decisions (often, though misleadingly, called ''*de novo* review'' about claims to benefits under ERISA, it derived this conclusion from an analogy to trust law. The court understood trust law to call for a non-deferential judicial role. ERISA fiduciaries are like common-law trustees, the justices thought, so judges normally should make independent decisions in ERISA litigation. In *Firestone*'s framework, deferential review is exceptional, authorized only when the contracts that establish the pension or welfare plan confer interpretive discretion in no uncertain terms.
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> Under *Firestone*, fiduciary status leads to independent judicial decisions, unless the contract specifies otherwise. To hold, as *Goldstein* does, that non-fiduciary status *requires*

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[17] *Id.* at 734.

[18] *Goldstein v. Johnson & Johnson*, 251 F.3d 433, 26 EBC 1193 (3d Cir. 2001) (103 PBD, 5/30/01; 28 BPR 1553, 6/5/01).

[19] *Id.* at 442.

[20] *Id.* at 442-443.

[21] *Id.* at 443.

[22] *Id.* at 444.

[23] *Id.* at 444-445.

[24] *Id.* at 446. In the Third Circuit, ''bad faith normally connotes an ulterior motive or sinister purpose.'' *McPherson v. Employees' Pension Plan of Am. Re-Ins. Co.*, 33 F.3d 253, 256, 18 EBC 1865 (3d Cir. 1994). Typically, to claim a breach of the covenant of good faith and fair dealing, a plaintiff must prove that the party alleged to have acted in bad faith engaged in some conduct that denied the benefit of the bargain originally intended by the parties. *See Violette v. Ajilon Fin.*, No. Civ. A. 03-5520, 2005 U.S. LEXIS 22859, *27-28, 36 EBC 1414 (D. N.J. Sept. 30, 2005)(unpublished) (194 PBD, 10/7/05; 32 BPR 2175, 10/11/05).

[25] *Craig v. Pillsbury Non-Qualified Pension Plan*, 458 F.3d 748, 38 EBC 1974 (8th Cir. 2006) (156 PBD, 8/15/06; 33 BPR 2012, 8/22/06); *see also Bender v. Xcel Energy, Inc.*, 507 F.3d 1161, 41 EBC 2857 (8th Cir. 2007) (209 PBD, 10/30/07; 34 BPR 2633, 11/6/07).

[26] 458 F.3d at 752.

[27] *Id.*

[28] *Id.*; Notably, the remaining circuits that have addressed these conflicting review standard views for top hat plans have decided to avoid taking a position on the question, choosing instead to punt and declare their decision would be the same under either a *de novo* or arbitrary and capricious review. *See, e.g., Acosta v. Bank of La.*, 88 F. App'x 688 (5th Cir. 2004).

[29] *Comrie v. IPSCO, Inc.*, 636 F.3d 839, 50 EBC 2473 (7th Cir. 2011).

> independent judicial decisions, *despite* a contract, is to turn *Firestone* on its head. *Firestone* tells us that a contract conferring interpretive discretion must be respected, *even when* the decision is made by an ERISA fiduciary. It is easier, not harder as *Goldstein* thought, to honor discretion-conferring clauses in contracts that govern the actions of non-fiduciaries.[30]

In sum, the Seventh Circuit found that when a federal statute, like ERISA, doesn't specify a review standard, then the discretion specified in the contract governs even if no fiduciary duties are in play. As a result, the *Comrie* court affirmed the Seventh Circuit's application of the *Firestone* standard to top hat plan claims.[31]

Do These Conflicting Standards Have Any Substantive Differences?

As these cases establish, there are at least two, if not three, different review standards applied by federal appellate courts for reviewing top hat plan benefit determinations.

Under the *Firestone* deference standard, a plaintiff must prove that a plan administrator's decision is ''downright unreasonable'' to succeed— not only a high hurdle, but one that requires objective evidence of unreasonableness.

On the other hand, the two ''exceptions'' to the *Firestone* rule appear on the surface to be very similar; however, on a deeper review, they employ two slightly different definitions of ''good faith.'' Specifically, the Eighth Circuit's ''reasonableness'' definition of good faith appears to be an objective proof standard, like that announced in *Firestone*. In *Craig*, the Eighth Circuit examines how an average plan administrator would consider the benefit question at issue.

On the other hand, the ''bad faith'' test adopted by the Third Circuit in *Goldstein* appears to have a more subjective element—was the benefit of the parties' bargain impacted by the plan administrator's decision. Under certain fact patterns, there likely is no difference. However, fact scenarios may exist where a plan administrator's interpretation of plan language is unreasonable, but the parties' benefit of the bargain isn't affected.

Under the *Firestone* and *Craig* standards, such a plaintiff would succeed on his or her claim; however, under *Goldstein*, the same plaintiff would fail to satisfy the proof standard.

The only ''fix'' for these conflicting standards would be for the Supreme Court to revisit its *Firestone* decision and set a review standard for *all* ERISA plans.

Short of such a blanket pronouncement from the court, it is unlikely that a uniform review standard in top hat plan litigation in the near future will be employed by all federal appellate courts. As a result, the potential for anomalous results in top hat plan litigation exists, which arguably defeats ERISA's goal of uniform federal benefit administration and claim determinations.

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[30] 636 F.3d at 842.
[31] *Id.* at 842-843.

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