

Publications

Third Circuit Issues Decision in Favor of Groom Client in Top Hat Plan Lawsuit

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The United States Court of Appeals for the Third Circuit recently issued a decision that promises to be one of the leading cases on executive compensation arrangements commonly referred to as top hat plans. *In re IT Group, Inc.* ___ F.3d ___, 2006 WL 1421016 (decided May 25, 2006). [Mike Prame](#) served as lead counsel and argued the case before the Third Circuit.

IT Group involved a deferred compensation plan established by a company that later went bankrupt. In the bankruptcy proceedings, the participants claimed that the deferred compensation plan did not qualify as an unfunded top hat plan. The participants claimed that, if the plan was not an unfunded top hat plan, it was not exempt from the funding, vesting and fiduciary provisions of ERISA and the company employees who were involved in the administration of the plan would have had a fiduciary duty to ensure that the company set aside money in a trust for the participants before the bankruptcy. The participants also claimed that the common law duties of good faith and fair dealing required money to be set aside for the participants in advance of the company's bankruptcy in order to avoid a forfeiture of the benefits the company owed to the participants under the plan.

A plan is a top hat plan if it 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. In ruling in favor of Groom's client on a case of first impression in the Third Circuit, the Court ruled that the following factors should be analyzed in determining whether a plan is unfunded: (1) whether plan beneficiaries can look to a separate res or fund to satisfy their claims; (2) whether beneficiaries have a legal right to the company's assets that is greater than that of a general unsecured creditor; and (3) what was the plan's intended and actual tax treatment.

The Third Circuit also limited the application of the common law duties of good faith and fair dealing in the context of top hat plans. In rejecting the participant's claim that these common law duties required money to be set aside in advance of the company's bankruptcy, the Court concluded that the implied duties of good faith and fair dealing cannot be used to add new terms to the plan or contradict existing terms.

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