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View From Groom: ERISA Does Not Apply—Bonus!

BY JOHN MCGUINESS AND DAVID ASHNER

Executive compensation arrangements come in many shapes and sizes. Employers have recently been quite focused on whether such arrangements are subject to section 409A of the Internal Revenue Code. But employers also need to know whether such arrangements are subject to the Employee Retirement Income Security Act. We outline below the contours of an important exemption from ERISA coverage: the bonus plan exemption.

ERISA Coverage Generally

ERISA only applies to "employee pension benefit plans" and "employee welfare benefit plans." Thus, in order to be covered by ERISA, an arrangement must:

- be a plan;
- cover employees; and
- qualify as either a pension plan or a welfare plan.

Whether an executive compensation arrangement amounts to a "plan" is often analyzed under the Supreme Court's decision in *Fort Halifax Packing Co. v. Coyne*, 482 U.S. 1 (1987). In that case, the Court held that a severance arrangement requiring one-time lump sum payments to employees upon a facility closing did not require an ongoing administrative scheme and, therefore, did not amount to a "plan." Thus, very simple executive compensation arrangements may be exempt from ERISA under the logic of *Fort Halifax*.

Even if an arrangement amounts to a "plan" under ERISA, the statute will not apply unless the plan covers employees. Thus, plans only covering non-employees, including those limited to non-employee members of a company's Board of Directors, are not subject to ERISA.

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Finally, even if a "plan" exists and it covers employees, it will only be subject to ERISA if it is a "welfare plan" or a "pension plan." This is where the bonus plan exemption comes in. As discussed below, plans qualifying as "bonus plans" will not be treated as pension plans and will be exempt from ERISA. Note that even if a plan is subject to ERISA, most of the substantive provisions will not apply if coverage under the plan is limited to a "select group of management or highly compensated employees" under the so-called "top hat plan" exemption.

Bonus Plan Exemption

Several different types of programs may fit within the bonus plan exemption, including the following:

- annual cash bonus plans;
- long-term (*e.g.*, three-year) cash bonus plans;
- equity compensation plans providing for awards of options, stock appreciation rights, restricted stock and restricted stock units; and
- retention bonus arrangements.

These and other similar arrangements are often found to be exempt from ERISA because they are neither "welfare plans" nor "pension plans" under ERISA.

Bonus Plans are not "Welfare Plans" Under ERISA. For a plan to qualify as an "employee welfare benefit plan" or "welfare plan" under ERISA, it must be established or maintained *for the purpose of* providing its participants with certain kinds of benefits, such as medical benefits, disability benefits, death benefits, or unemployment benefits. But even if a bonus arrangement incidentally results in participants receiving one or more of these kinds of benefits—for example, benefits under a bonus plan become payable after an employee becomes disabled—courts typically find that the arrangement still is not a welfare plan as long as its *purpose* is not the provision of welfare benefits. Bonus plans can generally demonstrate to the satisfaction of the courts that their main purpose is different, *e.g.*, to incentivize and reward employees for current performance.

Are Bonus Plans "Pension Plans" Under ERISA? A more heavily litigated issue is whether an employer's bonus arrangement qualifies as an "employee pension benefit plan" or "pension plan." Under ERISA, there

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are two ways that a plan can qualify as a pension plan. First, a plan that ''provides retirement income to employees'' is a pension plan. However, a pension plan under ERISA also includes a plan that ''*results in* a deferral of income by employees for periods extending to the termination of covered employment or beyond.'' Read literally, this definition could sweep into ERISA's coverage many bonus arrangements that result in payments being made to certain employees after termination.

Recognizing that Congress never intended to equate incentive compensation arrangements with pension plans, the Department of Labor adopted a regulation that specifically excludes bonus plans. But the exclusion does not apply if payments under the bonus plan are ''systematically deferred'' until the termination of covered employment or beyond or to provide retirement income. Thus, a critical inquiry for employers who sponsor bonus plans is whether payments under the plan are ''systematically deferred'' to the termination of employment.

In determining whether a particular incentive compensation arrangement constitutes an ERISA-covered pension plan or an exempt bonus plan, its express terms and the surrounding circumstances are considered. While no single factor is controlling, guidance issued by the Department of Labor and judicial opinions analyzing this issue seem to focus heavily on the timing of payments under the arrangement. Generally, if a plan imposes significant restrictions on participants' rights to receive payments prior to the termination of employment, courts are more likely to find that the plan is ineligible for the bonus plan exemption because it ''systematically defer[s]'' payments until termination. In fact, if even a subset of benefits under the plan is subject to significant pre-termination restrictions, there is a risk that the entire plan could be treated as a pension plan under ERISA. *See*, *Bingham v. FIML Natural Resources* (D. Colo. June 18, 2013). However, if plan payments are typically made while participants are employed and post-termination payments are ''incidental'' or ''happenstance,'' courts typically find that the bonus plan exemption applies.

Below are some other common questions that courts ask in conducting this bonus plan exemption analysis:

■ **How is the purpose of the plan described?** Courts look to provisions in the plan itself, as well as communications to participants, for clues as to whether the plan is intended to provide deferred income or to incentivize and reward employee performance. The Ninth Circuit recently stated that in analyzing this issue, it ''agree[s] with our sister circuits that have determined that the paramount consideration is whether the primary purpose of the plan is to provide deferred compensation or other retirement benefits.'' *Rich v. Shrader*, No. 14-55484, 2016 BL 164520 (9th Cir. May 24, 2016) (101 PBD, 5/25/16); *see also*, *Tolbert v. RBC Capital Markets Corp.*, 758 F.3d 619, 622 (5th Cir. 2014) (Employer's wealth accumulation plan was deemed to be a pension plan subject to ERISA where the plan document described the plan as ''a nonqualified, deferred compensation plan . . . designed to provide an opportunity for such employees to invest a portion of their compensation in tax-deferred savings and investment options in an effort to support long-term savings'') (136 PBD, 7/16/14).

■ **Are deferrals required or discretionary?** If plan participants can elect to receive benefit payments while still working, benefits under the plan typically are not treated as ''systematically deferred,'' even if participants can also elect to defer payments to termination of employment or beyond. *See, e.g.*, *Houston v. Aramark Corp.*, 112 Fed. Appx. 132, 136 (3d Cir. 2004).

■ **How are benefits determined?** If benefit amounts are set based on employee or company performance, the arrangement is more likely to resemble a bonus plan. *See, e.g.*, *Murphy v. Inexco Oil Co.*, 711 F.2d 570, 575-76 (5th Cir. 1980) (Plan fell within the bonus plan exemption where each participant's eligibility for benefits under the plan was determined ''only according to the management's assessment of his contribution to the financial well-being of the company.'').

Equity Compensation Arrangements. Sponsors of equity compensation arrangements (which often provide for payments up to 10 years after grant) can take comfort from the case law in this area. Generally, courts have held that where an equity compensation arrangement provides the right to receive amounts while still employed, then the plan is not treated as ''systematically deferr[ing]'' income for purposes of the bonus plan exemption. *See, e.g.*, *Emmenegger v. Bull Moose Tube Co.*, 197 F.3d 929, 933 (8th Cir. 1999) (''While a participant may postpone redemption of PSP shares until termination or retirement, this is strictly at the option of the participant, and there is nothing in the terms of the program that would result in such deferral with the purposeful consistency required to make deferral systematic.''). In one case, benefits under a long-term incentive compensation plan were held not to be subject to ERISA even though certain restrictions on the awarded shares were not removed until participants turned age 65. *See International Paper Co. v. Suwyn*, 978 F. Supp. 506, 512 (S.D.N.Y. 1997) (holding that any deferral of income under the program was merely incidental).

Consequences of ERISA Coverage

If an arrangement is treated as a pension plan subject to ERISA and is not limited to a ''top hat'' group, many substantive requirements of ERISA apply, including:

- annual Form 5500 filings;
- summary plan descriptions must be delivered to participants;
- funding benefits in a trust;
- minimum participation rules;
- vesting rules; and
- fiduciary responsibilities.

Compliance with these many requirements may well be the result for a broad-based program that does not fit within the bonus plan exemption (*e.g.*, a $5,000 ''bonus'' paid only to long-service employees).

Conclusion

Employers should carefully analyze whether their equity compensation and other executive compensation arrangements are exempt from ERISA under the bonus plan exemption or otherwise. If an arrangement is not exempt and not limited to a ''top hat'' group of partici-

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pants, it could be subject to the extensive requirements for pension plans under ERISA.