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ERISA Nonqualified Deferred Compensation Plans, Restrictive Covenants, and ERISA Preemption

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Although typically the province of state law, Employee Retirement Income Security Act ("ERISA") preemption may override state law limitations when forfeiture-for-competition covenants come within the purview of an ERISA benefit plan. Valid forfeiture provisions in ERISA plans, therefore, may be enforced even in states where forfeiture-for-competition clauses are not typically enforceable.

The most suitable type of ERISA plan for a forfeiture-for-competition clause is a type of nonqualified deferred compensation plan colloquially known as a "Top Hat Plan." Top Hat Plans are a category of unfunded ERISA plans maintained "primarily for the purpose of providing compensation to a select group of management or highly compensated employees."[1] In general, "ERISA preempts state law regarding forfeiture of retirement benefits."[2] ERISA also has been found to preempt state laws limiting the enforcement of non-competition clauses in Top Hat Plans.[3] This suggests that employers with Top Hat Plans including forfeiture-for-competition clauses could use those forfeiture clauses to enforce restrictive covenants that would otherwise violate state law if provided under an agreement not subject to ERISA.

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Top Hat Plans with embedded forfeiture-for-competition clauses also could afford employers advantages in adjudicating whether departing employees violated their non-competition obligations. If Top Hat Plan documents clearly state that the plan administrator maintains discretionary authority to determine benefits eligibility and to construe the terms of the Top Hat Plan, many courts will afford the plan administrator's determination a deferential standard of review.[4] Employers sponsoring a Top Hat Plan with embedded forfeiture-for-competition clauses should proceed with their eyes open concerning what this provision can and cannot accomplish. A restrictive covenant in a Top Hat Plan does not directly prohibit the behavior; rather, it is only enforceable to the extent compensation is forfeited as a result of the behavior. Further, the purpose of a traditional Top Hat Plan is to provide a stream of retirement income to key executives and not necessarily as a tool to enforce restrictive covenants, so any restrictive covenant provisions should be considered in the context of the purpose of the Top Hat Plan, the plan design, and the overall compensatory policies of the employer.

ENDNOTES

[1] 29 U.S.C. § 1051(2).

[2] *Thomas v. Bostwick*, No. 13-cv-02544-JCS, 2014 U.S. Dist. LEXIS 123524 (N.D. Cal. Sep. 3, 2014).

[3] *Conklin v. Brookfield Homes Holdings, Inc.*, No. SACV 08-00452-CJC(PJWx), 2009 U.S. Dist. LEXIS 134870 at *10 (C.D. Cal. Oct. 6, 2009) (enforcing forfeiture-for-competition clause in Top Hat Plan against California employee); *Clark v. Lauren Young Tire Ctr. Profit Sharing Tr.*, 816 F.2d 480 (9th Cir. 1987)("ERISA preempts state law with respect to non-competition forfeiture clauses."); *Lojek v. Thomas*, 716 F.2d 675 (9th Cir. 1983) ("The district court correctly decided that ERISA has preempted Idaho law

and that federal law governs the validity of the plan."); *Elbling v. Crawford & Co.*, No. 16cv2951-L(KSC), 2018 U.S. Dist. LEXIS 53521 (S.D. Cal. Mar. 28, 2018) (state law denial of benefits claims preempted by ERISA).

[4] *Elbling*, at *8 ("[T]he Ninth Circuit reviews administrators' decisions regarding top hat plans for abuse of discretion when the plan gives the plan administrator discretionary authority to resolve claims."); *Wall v. Alcon Labs. Inc.*, 551 F. App'x 794, 799 (5th Cir. 2014) (plan administrator's determination that plaintiff "violated the non-compete clause" in Top Hat Plan is subject to "arbitrary and capricious" standard of review).