

*"[A] plan should not place on participants the burden of proving that they have not competed with the employer."*

## FORFEITURE OF NONQUALIFIED BENEFITS FOR VIOLATING NONCOMPETE: BURDEN OF PROOF

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A federal trial court held that it was unreasonable to deny nonqualified deferred compensation benefits for violation of a noncompete where the executive had the burden of proving that he or she had not been in competition with the employer. *Violette v. Ajilon Finance*, 2005 WL 2416986, 32 EBC 1414 (D. N.J. 2005).

Notably, the court reviewed the plan committee's denial of benefits on the basis of whether the committee's decision was made in good faith. This is normally an easy standard for a committee to satisfy. The court explained that as a "top-hat" plan, the normal determination of the appropriate standard of review for a plan subject to ERISA does not apply. The court instead treated the top-hat plan as a unilateral contract and applied the federal common law of contracts to determine how carefully it should review the committee's decision. In this case, the plan document granted the committee the power to make conclusive decisions concerning the plan's terms. The court accepted this, but noted that in making its determinations the committee is subject to an implied duty of good faith and fair dealing.

The court held that the committee violated its duty of good faith by acting in bad faith in deciding the participant violated the plan's noncompete requirements. That was because the committee enforced a plan provision placing on the participant the burden of proving that he was not violating the noncompete. The court said this effectively required that the participant prove a negative, which the court held to constitute an unreasonable requirement. The court also found that the committee gave the participant inadequate guidance on how to satisfy his burden of proof. The participant had, in fact, given the committee financial information and made representations about why his business did not violate the provisions of the noncompete, but was not told what additional information he should provide to satisfy his burden of proof.

**Lesson.** The lesson of the decision is that although an employer's nonqualified deferred compensation arrangements can and should provide a plan committee with broad discretion to determine whether and when benefits are due, and although a plan may provide for the forfeiture of benefits upon violation of a noncompete requirement, a plan should not place on participants the burden of proving that they have not competed with the employer. Instead, the plan should give the committee broad power to determine whether a participant is entitled to benefits, and to require the participant to provide any information requested by the committee to help it in making its determination.