Blitman&King LLP

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CUEd In:

The Law and Business of Employee Benefits for Credit Union Executives

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Fun facts about CUEd In:

Our readership consists of 1,000 executives from credit unions in 9 different states

With the release of this issue, CUEd In celebrates the one-year anniversary of its inaugural issue and we want to thank you for reading our guide to the law and business of employee benefits for credit union executives. Over the course of the past year we've enjoyed educating executives of credit unions about key employment and employee benefit matters. We enjoy receiving your feedback and comments, as well as topics that may interest you for future articles, so please feel free to continue to contact us at cuedin@bklawyers.com.

In this issue, we spotlight a case involving an executive that rose through the ranks to senior management and following a merger resigned only to be denied benefits due under her employment and incentive agreements. In this case, the court takes aim at the Board's process of reviewing the executive's claim for benefits, which included a biased investigation conducted by the Board's outside counsel.

We also highlight how important it is for federal credit union executives to understand technical timing requirements contained in deferred compensation plans including, but not limited to, split-dollar life insurance arrangements. The case we examine illustrates the lost opportunity of an executive to secure a future death benefit payment based on a failure to comply with the terms of the deferred compensation agreements at issue.

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Understanding "Good Reason" Resignations Following A Merger

i'm not telling you it is going to be easy, i'm telling you it's going to be worth it.

According to a recent court decision, Louise McCarthy ("McCarthy") a former Senior Vice President, Senior Counsel and Assistant Secretary of The Commerce Group, Inc. can continue with her claim alleging that her employer violated her rights under ERISA by rejecting her "good reason" resignation and thereby denying her plan benefits.[1]

A hypothetical credit union example based on the facts of McCarthy v. The Commerce Group, Inc. A talented young lawyer, McCarthy, joins the Commerce Group Credit Union ("Commerce Credit Union") as assistant manager. During her tenure from 2001 through 2008, McCarthy steadily rises through the ranks from assistant manager to a position of senior management. As a member of senior management, McCarthy enters into an employment agreement that provided a significant severance payment, as well as life and health insurance benefits, in the event she resigned for "good reason" following a "change in control." Under McCarthy's employment and incentive agreements, she would be entitled to $3.5 million in the event her resignation was with "good reason."

The Commerce Credit Union undergoes a merger, and one-day after the closing of the merger, McCarthy submits a notice of intent to resign for good reason pursuant to her employment agreement. McCarthy's notice states that she has "good reason" to resign since after the merger her employment responsibilities changed substantially resulting in loss of status and prestige.

The Board investigates McCarthy's Claim for Benefits, or does it really? Under the terms of her employment agreement, the Board of Directors ("Board") of the Commerce Credit Union determines whether "good reason" exists and the Board's decision is "conclusive and binding." The Commerce Credit Union did not adopt any specific procedures for determining good reason claims to guide the Board in reaching a decision.

The Board did not dispute the requisite "change in control" occurred, but nonetheless hired a large law firm to investigate the merits of McCarthy's claim for benefits. At issue is whether "good reason" exists which is defined, in part, by McCarthy's employment agreement as:

(i) a substantial and adverse alteration in the nature, status, or prestige of the Executive's responsibilities, title, authority, powers, functions, duties or reporting requirements, taken as a whole, as compared to the Officer's responsibilities, title, authority, power, functions, duties or reporting requirements, taken as a whole, immediately prior to the Change in Control...

The law firm conducts interviews of employees and search-

1 *McCarthy v. The Commerce Group, Inc.*, D. Mass., No. 1:109-cv-10161-PBS, 12/16/11.

es McCarthy's email, but does not interview McCarthy herself. Based on its investigation, the law firm submits a memorandum to the Board and the Board meets with McCarthy.

During a conference call meeting with the Board, McCarthy explains what she felt was a diminishment in scope of authority, status, and prestige. Specifically, she mentions the elimination of her corporate governance duties and her lack of access to the ultimate decision makers for the company (which are now the acquiring credit union executives since the role of the executives of the target credit union have been minimized). McCarthy spent approximately 45 minutes explaining her "good reason."

Based largely on the law firm's memorandum, the Board determines, in five minutes, that McCarthy had not shown "good reason" for her resignation and therefore denies her entitlement to payment. One Board member explains the brevity of the deliberation process by stating "[w]e didn't need a long time to discuss" and "...we can't understand and we can't support this kind of complaint."

The Board sends McCarthy a letter notifying her that the "good reason" claim had been denied and, without providing a reason for the denial, stating "After full consideration, the Board...determined that there is no 'Good Reason' as that term is defined in both your Employment Agreement and any Incentive Award Agreement for your resignation."

Taking executive action, McCarthy attempts to appeal the decision and requests information from the Board, but receives no response. McCarthy sues the Board and argues that the Board violated ERISA's procedural mandates when considering her claim for benefits because it did not properly follow the statutory notice provisions and full and fair review requirements. The court finds that McCarthy's employment agreement and incentive agreements are top-hat ERISA plans, which are unfunded employee benefit plans maintained primarily to provide deferred compensation or welfare benefits for a select group of management or highly compensated employees.

The court finds that McCarthy's employment agreement and incentive agreements are top-hat ERISA plans, which are unfunded employee benefit plans maintained primarily to provide deferred compensation or welfare benefits for a select group of management or highly compensated employees.

What's the Board's response? The Board argues that the plans (the employment agreement and incentive agreements) are not subject to ERISA's "full and fair review" requirements because such review is undertaken by the "named fiduciary"—a term of art defined within ERISA's fiduciary responsibility provisions—and top-hat plans are exempt from ERISA's fiduciary responsibility provisions.

The court's take on all of this—after a 7 day trial, the court issues a 72 page opinion. The court rejects the Board's argument and holds that the Board, as plan administrator, must apply the full and fair review standard even though the Board, as plan administrator, was not functioning as an ERISA fiduciary. The court stated, even in the context of top-hat plans, "[f]ull and fair review is a component of good-faith plan administration."

The court ultimately found that McCarthy did not receive a full and fair review. The court noted that the Board spent 5 minutes debating the merits of McCarthy's claim after meeting with her. The court also questioned the Board's almost exclusive reliance on a memorandum prepared by a "biased" outside investigator (i.e., the law firm retained by the Board to conduct the investigation). In addition to containing several factual inaccuracies, the court also noted that the memorandum underestimated McCarthy's job responsibilities and did not even address the diminishment of her post-merger position.

In addition, the court held that the Board did not follow ERISA's reporting and disclo-

sure requirements. Specifically, the Board failed to provide McCarthy an appeals process or access to documents relevant to her claim.

And, in its final blow to the Board, the court held that the Board had a structural conflict of interest that tainted its determination of McCarthy's claim. In this regard, the court found certain evidence persuasive that the Board continually sought to avoid "good reason" payouts in connection with the merger which, in sum, amounted to approximately $100 million. In closing, the court noted that the Board "neglect[ed] to provide even the bare-bones of ERISA's core protections."

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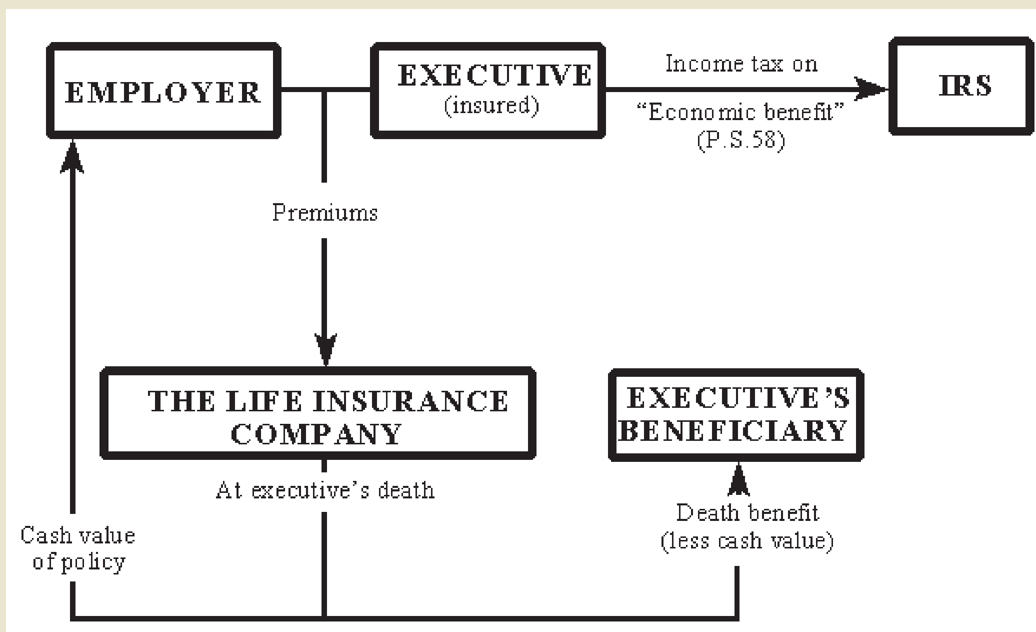
Live to fight another day. The court remanded the matter back to the Board for a full and fair review and imposed certain conditions on the Board. These conditions include prohibiting the Board from placing any reliance on the past investigation or memorandum as well as requiring the Board to hire a neutral judge or law firm—subject to the court's approval— to investigate McCarthy's claim. The court also awarded McCarthy her attorney's fees associated with the lawsuit.

Split-dollar arrangements may look complex, but the principle of this article is simple: Timing is Everything



In *Precious Plate, Inc. v. Russell,*[2] the court ordered a Vice President of Human Resources to execute the necessary documents to transfer a life insurance policy to the executive's former employer based on the failure of the executive to make a timely election upon retirement. This deprived the executive of the opportunity to pay the employer an amount equal to the employer's interest in the life insurance policy and thereby secure future payment of the death benefit due under the policy. The lesson of this case is that credit union executives need to understand the legal implications of technical timing requirements contained in deferred compensation plans including, but not limited to, split-dollar life insurance arrangements.

A hypothetical credit union example based on the facts of Precious Plate, Inc: depending on the cause of death, it may be less painful. Let's say a credit union executive—named John Russell ("Russell")—enters into a deferred compensation plan with Precious Plate Credit Union ("Precious") in 1985. This plan is not offered to any other of Precious's employees. Russell is issued a life insurance policy and, at the same time, executes an "Assignment of Life Insurance Policy as Collateral" and a split-dollar agreement, by which Russell assigns the policy to Precious as collateral for amounts advanced by Precious under the agreement. Upon Russell's death, Precious agrees to take whatever action is necessary and required to collect the proceeds of the policy and to pay $150,000 to the designated beneficiary.

The lesson of this case is that credit union executives need to understand the legal implications of technical timing requirements contained in deferred compensation plans including, but not limited to, split-dollar life insurance arrangements.

In 1989, the parties enter into a second, identical deferred compensation plan consisting of whole life insurance and an assignment of the policy as collateral for an advancement under a second split-dollar agreement. Russell reserves the right to designate and change the beneficiary under both agreements.

Did the parties anticipate what happens when their employment relationship ends? Both the 1985 and 1989 split-dollar agreements contained identical provisions specifying the parties' rights upon termination of Russell's employment with Precious. Each provided that Russell would have, for the 30 days immediately following the date of termination, the right to obtain a release of the assignment of the policy by paying Precious an amount equal to Precious's interest in the policy. Upon such payment, Precious would release its interest in the policy to Russell.

In addition, the agreements provided that, if Russell failed to make the required payment within 30 days of termination of his employment, Russell agreed to transfer all of his rights, title and interest in the policy to Precious, which could thereafter deal with the policy in any way it may see fit.

Russell retires and fails to take any action. Russell retires, with his employment ending on December 31, 2005. Russell does not make the required payment to Precious within 30 days but nonetheless refuses to execute the necessary documents to transfer his rights and interest in the policies to Precious. Precious never explained the 30-day provision to Russell and never advised him that it would rely on the provision despite Russell's repeated inquiries regarding his rights and obligations under the agreements. Further, Russell maintains that he had, at all times, been willing and able to make the required election under the agreement and fully reimburse Precious for premiums paid.

Precious sues Russell in court. Precious brings suit against Russell in New York State Supreme Court, which was later removed to the U.S. District Court for the Western District of New York. Precious set forth five causes of action in its amended complaint, whereby it seeks declaratory relief and specific performance pursuant to both ERISA and state law, and damages for breach of

2 W.D.N.Y., No. 1:06-cv-00546-JTC-LGF, 8/22/11.

contract. Russell files a counterclaim for breach of contract and ERISA violations, including breach of fiduciary duty and failure to distribute a summary plan description ("SPD") and other required plan documents.

Is this split-dollar life insurance arrangement subject to ERISA? The court first held that the plans were unfunded "top-hat" plans, and thus were not subject to ERISA's fiduciary requirements. The court noted that ERISA § 201(2) defines a "top-hat" plan as "a plan 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."

First, Russell conceded that the plan was maintained exclusively for him, a highly compensated management employee. Next, the court was able to conclude that the plan was unfunded pursuant to New York court cases, which provide that a plan is unfunded when benefits thereunder are paid solely from the general assets of the employer.[3] The court noted that Precious had the sole right to collect the policy proceeds at death or maturity or to surrender the policy for its cash value and, once Precious collected the policy proceeds, those funds would become part of the general assets of the corporation. As a result, Russell's beneficiary's claim to Russell's share of the policies was a claim against the corporation, not the insurance company, leaving Russell with rights no greater than any unsecured creditor of Precious. Therefore, because the plans were top-hat plans under ERISA, ERISA's fiduciary provisions did not apply, and Russell's breach of fiduciary duty claims were consequently dismissed.

Therefore, because the plans were top-hat plans under ERISA, ERISA's fiduciary provisions did not apply, and Russell's breach of fiduciary duty claims were consequently dismissed.

Even still, I should have still gotten an SPD, no? Next, the court denied Russell's motion for summary judgment on the claims brought under ERISA for Precious's failure to provide an SPD and other plan documents. The court noted that, even though the plan was a top-hat plan, it nonetheless remained subject to ERISA's disclosure requirements, which includes a mandate that the plan administrator furnish an SPD to plan participants and beneficiaries. Although Precious conceded that it had not prepared an SPD or provided one to Russell, the court cited to New York court cases finding that an ERISA claim premised on the complete absence of an SPD also requires a showing of likely prejudice.[4] The court determined that Russell did not show the requisite prejudice because he was in possession of the relevant documents, he was Precious's corporate officer responsible for labor matters and employee benefits, and he did not show that he requested documents that were not provided. As a result, Russell's remaining ERISA counterclaims were dismissed.

The court determined that Russell did not show the requisite prejudice because he was in possession of the relevant documents, he was Precious's corporate officer responsible for labor matters and employee benefits, and he did not show that he requested documents that were not provided.

Sorry Russell, you're out of luck. Finally, the court granted Precious's motion for summary judgment on its ERISA causes of action. The court stated that ERISA plans are construed according to federal law, and are therefore interpreted as a whole, giving terms their plain meanings. Considering that Russell was required under the plain language of the agreements to make an election

3 *Demery v. Extebank Deferred Compensation Plan (B)*, 216 F.3d 283, 287 (2d Cir. 2000).
4 *Weinreb v. Hospital for Joint Diseases Orthopaedic Institute*, 404 F.3d 167, 171 (2d Cir. 2005); Burke v. Kodak Retirement Income Plan, 336 F.3d 103 (2d Cir. 2003).

within 30 days of termination of his employment and he failed to do so, he was therefore obligated to transfer all of his rights, title and interest in the policies to Precious. Correspondingly, the court ordered that Russell execute the necessary documents to facilitate the transfer as per the agreement.

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