Blitman&King LLP

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CUEd In:

The Law and Business of Employee Benefits for Credit Union Executives

In this Issue

Welcome to the third issue of CUEd In, our guide to the law and business of employee benefits for credit union executives. In this issue, we take a look at a recent case involving the recovery of incentive plan benefits by executives and the impact that waivers and releases can have on a credit union executive's compensation package. We examine a timely opportunity for strategic credit unions—or a coalition of said—to further cement their influence within their state's community while seizing upon a business opportunity presented by health care reform.

We discuss a court case involving an unfortunate situation for retired Chrysler executives to illustrate the legal framework applicable to supplemental retirement executive plans (SERPs) and potential pitfalls that many executives are not aware of. And, through this issue's Litigation Corner, we aim to assist credit union executives better understand how a recent U.S. Supreme Court decision involving ERISA remedies will impact the operations of employee benefit plans that their credit union sponsors for its employees.

In addition, CUEd In is now a LinkedIn Group. You may visit the CUEd In LinkedIn page and join the group here: http://www.linkedin.com/pub/jonathan-cerrito/37/330/60. Through this group, we will be disseminating information and updates for credit union executives.

This issue is jam-packed with information so let's jump in...

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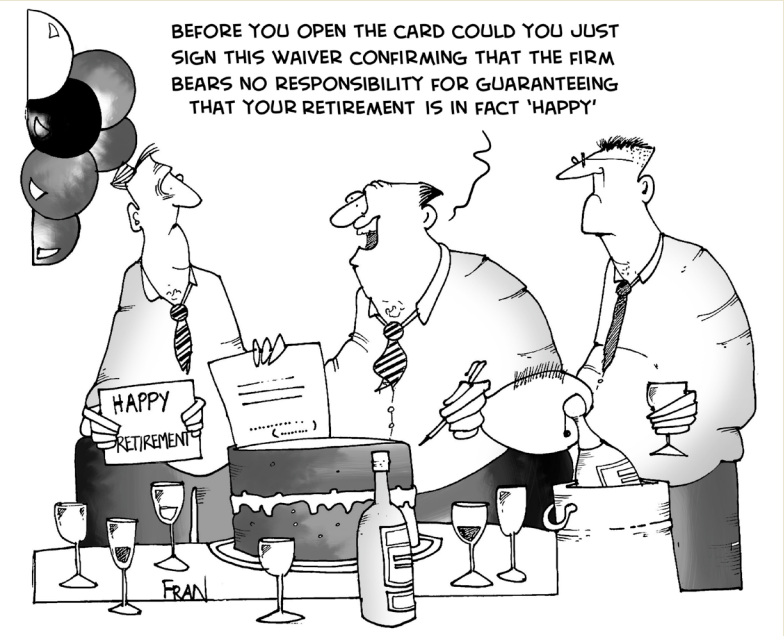
Waiver Provisions in Executive Compensation Packages Carry Heavy Ramifications

The advice that credit union executives should always read a document before signing remains sound, especially in light of a recent court ruling. In *Nye v. Ingersoll Rand Co.*, the court found that executives were entitled to benefits from two different incentive plans that they had enrolled in, despite the claim that their entitlement under the initial plan had expired.[1] The result of this case is important for two reasons. First, you may be entitled to benefits based on the specific terms of an agreement, regardless of any representations to the contrary. Second, the positive result for the executives is unlikely to be repeated, as institutions and their counsels heed the warnings of the case and include more clearly defined waivers in their offers.



A hypothetical credit union example based on the facts of Nye. Let's say a Board of Directors of a credit union wants to solicit merger offers. As part of its efforts to entice suitors, the Board devises an incentive plan that offers benefits to executives remaining with the credit union following its acquisition. This plan is aimed at making the credit union more attractive by encouraging key executives to undertake efforts to increase the value of the credit union and continuing to retain such executives following its acquisition. Under the terms of the plan, the credit union awards enrolled executives cash compensation in an amount tied to the final purchase price. The plan contains a clause making it effective until the credit union is acquired and does not contain a limitation on the length of the plan, nor does it provide the right for the credit union to unilaterally cancel it. The executives complete the appropriate paperwork and are enrolled in the plan. However, the credit union does not immediately receive any interest from other credit unions and decides to cease its merger efforts.

Four years later, the credit union receives a merger offer. In response to this offer, the target credit union creates a second incentive plan to prevent the retirement or defection of executives from jeopardizing the potential merger. The target credit union announces to executives that the prior incentive plan is no longer in effect. The target credit union then offers executives the option of enrolling in the new incentive plan. In the enrollment documents for the new plan, no portion suggests that the executives forfeited any rights by enrolling. The merger of the credit unions is eventually finalized.

Following the merger, the combined credit union makes payments to executives enrolled in the new incentive plan, but do not make any payments under the prior incentive plan. Enclosed with the benefit check, under the new incentive plan, was a statement from the com-

1 *Nye v. Ingersoll Rand Co.*, Civ No. 08-3481, 2011 U.S. Dist. LEXIS 50258 (D. N.J. May 10, 2011).

bined credit union informing the executive that by endorsing the check, the executive agrees that the "payment represents payment in full for any and all amounts owed to you under the Program and its predecessors." The executives sue the credit union to recover the benefits owed under the prior incentive plan.

What does the court say? The court finds that the language of the prior incentive plan was "perfectly clear", that the prior plan was effective until the credit union was acquired, and that the prior incentive plan remained valid. Moreover, the court finds that the subsequent incentive plan did not present the expiration or surrender of the benefits under the prior incentive plan as a term or condition of the subsequent incentive plan. Rather, the Court notes that "[the credit union] is a sophisticated entity represented by sophisticated counsel."

Further, the court notes, the credit union had the opportunity and the ability to condition the receipt of benefits under the subsequent incentive plan on the release of benefits under the prior incentive plan, and to draft language to that effect. Based on the failure to include such a provision, there was no release, waiver of rights, or accord and satisfaction that divested the executives of their interest under the prior incentive plan. Even the purported release that accompanied the payment checks, due to the absence of a reference to the prior incentive plan by name, failed to provide sufficient clarity to warrant a finding of accord and satisfaction. Thus, the executives are entitled to benefits under the prior incentive plan.

What does this means to you? The practical impact of this case for credit union executives extends beyond the facts considered. In light of the court's decision, it is likely that credit unions, just like other employers, will be overly cautious in ensuring that some form of release or waiver language is present in the terms and conditions of enrollment for any incentive or compensation plan. While simple boilerplate language may be sufficient to alleviate the credit union's concerns, the potential exists that the receipt of benefits could be conditioned on a waiver that the executive has not evaluated in full.

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In reviewing the rights and benefits forfeited by participation in certain incentive or compensation programs, credit union executives should give special consideration to the financial ramifications of enrollment. In Nye, the subsequent incentive plan offered benefits that were inferior to those under the prior incentive plan. If a valid waiver existed in the subsequent incentive plan, executives could potentially have received a lesser benefit by enrolling in the later plan.

Finally, the case is instructive in that credit union executives must be cautious to exercise their own independent review of any enrollment documents, and not rely upon any summary descriptions. If the executives, in Nye, had relied on the description provided to them, they would not have received benefits under the prior incentive plan and would potentially have left significant compensation on the table.

State Exchanges Present Unique Opportunities for a Credit Union or Credit Union Coalition

Health care reform may present an opportunity for credit unions to further cement their influence within the community while seizing upon a business opportunity. In this regard, the timing may be ripe for credit unions, or a credit union coalition, to seize their place in the health care marketplace by creating and offering "Qualified Health Plans" through Exchanges under health care reform. A Qualified Health Plan will be a separate and independent entity—structured as a cooperative (much like credit unions themselves)—that offers medical coverage to the public at large. The medical coverage will provide three fixed levels of benefits and also have the benefit of federal subsidies for low-income individuals.

The federal government—through the Department of Health and Human Services ("HHS")—will mandate certain requirements on the State Exchanges. On July 11, 2011, HHS released proposed rules outlining the requirements for states to establish new state-based competitive health insurance marketplaces (referred herein as "Exchanges") as required under health care reform. Starting in 2014, individuals and small businesses will have the ability to purchase health insurance through Exchanges, which are intended to provide essential health benefits coverage at affordable prices.

Under HHS's proposed rules, states have flexibility in determining how they will structure their Exchanges. Exchanges can be structured as non-profit entities, stand-alone public agencies, part of an already existing public agency, or as any combination of the three. Among other things, the Exchanges will certify health plans as Qualified Health Plans eligible to be offered on the Exchange, operate a website to facilitate comparisons among Qualified Health Plans for consumers, operate a toll-free customer support line, conduct outreach and education regarding Qualified Health Plans, and facilitate enrollment in Qualified Health Plans. States must submit written plans for complying with the rule's Exchange requirements to HHS for approval no later than January 1, 2013.

Individuals with incomes that are at or below 400% of the federal poverty level who purchase health coverage from a Qualified Health Plan will be eligible for a federal premium assistance tax credit towards the cost of the coverage.

At the state level, the creation of Exchanges is beginning to take root and early entry into this realm may help influence the eligibility of those that may offer Qualified Health Plans as well as the structure of a given state's Exchange. In fact, some states have already commenced taking measures to lay the foundation for the state's Exchange. For example, New York State Governor Cuomo announced on June 13, 2011, that he submitted legislation establishing New York's Exchange under health care reform. Governor Cuomo's proposed Exchange will be established as a public benefit corporation managed by a seven member Board of Directors, which will consult with an eighteen-member Advisory Committee composed of stakeholders and sectors that will be impacted by the operation of the Exchange, including small businesses, the medical community, and health care consumers. The Exchange would begin offering qualified health coverage to businesses and individuals on or before January 1, 2014. However, what New York's Exchange will exactly look like and what entities will be approved for offering Qualified Health Plans remains open.

Silly retired executives, Congress ain't gonna protect you.

In *Loffredo v. Daimler AG*, retired executives—whose supplemental executive retirement benefits did not survive Chrysler's bankruptcy—learned they have no remedy available under state law because the Employee Retirement Income Security Act of 1974, as amended ("ERISA") governed their plan.[2] As a result, executives age 62 or older will no longer receive supplemental retirement benefits. Take heed and, among other things, understand the legal framework of what you're negotiating, be proactive early and formally obtain the Board's/credit union's position.

Understand the legal framework of what you're negotiating. The executives participated in a supplemental executive retirement plan ("SERP"). A SERP is generally structured as a "top-hat plan"— an unfunded plan whose participation is limited to a select group of management or highly compensated employees—aimed at providing retirement security beyond the benefits of a tax-qualified pension plan.

Even though a SERP's assets may be held in a rabbi trust, the assets remain unprotected from creditors of a credit union and vulnerable to the risk that the assets would be lost due to insolvency. It is this risk that allows credit union executives to avoid any present tax liability on the credit union's contributions to the SERP.

In addition, although SERPs are governed by ERISA, they are exempt from many of ERISA's provisions, including the fiduciary duty provisions. Under ERISA, fiduciaries are obligated to act prudently and solely in the interests of plan participants and beneficiaries. Congress exempted top-hat plans from ERISA's fiduciary requirements because executives have the bargaining power to negotiate particular terms and monitor their interest under the plan, and therefore they do not need ERISA's protections. Really?! Many executives do not realize they may be flying solo—i.e, without the protection of certain laws—in their dealings and negotiations surrounding SERPs.

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Be proactive early, even respected tax counsel wouldn't be hard pressed on the Hobson's choice of whether to receive zero compensation or suffer the adverse tax consequences associated with receipt. In 1998, Chrysler agreed to a merger, and upon learning of this transaction, the executives became concerned that their benefits would be at risk if the post-merger entity became insolvent or filed for bankruptcy. At the time, the executives had the option of continuing to work or terminate their employment and immediately access certain of their benefits.

In deciding to continue their employment post-merger, the executives relied on a letter between the merging entities [not directed to them] which—according to the executives' personal understanding—meant that the rabbi trust would have

2 E.D. Mich, No. 2:10-cv-14181-JAC-VMM, 6/6/11.

sufficient assets to cover the SERP's obligations. The executives also assert that Chrysler securitized benefits for certain other active and retired executives by, among other things, purchasing annuities, but did not do so for them. There is no mention in the record that the executives attempted to negotiate for similar treatment. In addition, the executives alleged that Chrysler intentionally failed to disclose the serious financial trouble of the company. On all of these grounds, the executives sued under state law for, among other things, breach of fiduciary duty, age discrimination and silent fraud.

Formally Obtain the Board's/ Credit Union's position. The executives thought they understood Chrysler's position, however, as often happens once litigation commences things quickly changed.

Chrysler affirmatively argued, in its motion to dismiss the lawsuit, that the claims of the executives are completely preempted and governed by ERISA. Chrysler argued that because ERISA excludes top-hat plans from its fiduciary duty provisions the executives cannot bring any state or federal breach of fiduciary duty claims. The executives proclaimed that their state law fiduciary breach claim is not preempted by ERISA because top-hat plans are exempt from ERISA's provisions and, as such, state law governs their claim. The executives argued, in the alternative, that even if ERISA governs the court should consider their claims under ERISA.

In granting Chrysler's motion to dismiss, the U.S. District Court for the Eastern District of Michigan found that the executives' state law based fiduciary breach claim was completely preempted by ERISA and therefore could not be considered. The court went on to construe the allegations underlying the other claims as if such allegations had been asserted under ERISA but found that none of the allegations amounted to an ERISA violation.

Litigation Corner

The U.S. Supreme Court's recent decision in *Cigna Corp. v. Amara* expands the relief and remedies available under the Employee Retirement Income Security Act of 1974, as amended ("ERISA").[3] This Litigation Corner is intended to assist credit unions better understand how the *Amara* decision will impact the operations of employee benefit plans they sponsor for employees.

Originally, the case involved a class action of over 27,000 participants in the CIGNA Pension Plan. During 1996 and 1997, CIGNA converted its defined benefit pension plan to a cash balance plan, and the participants challenged whether the conversion violated the age discrimination and anti-cutback requirements of the benefits laws. The District Court in Connecticut held that the conversion was lawful, but it concluded that statements in CIGNA's summary plan descriptions were incomplete, false, or mislead-

3 Docket No. 09-804, 563 U.S. ___ (May 16, 2011)

ing. As a remedy, the District Court ordered the reformation of the plan such that participants could receive the benefits as described in the misleading documents, and it ordered CIGNA to pay the benefits in accordance with the reformed plan, plus interest.

At the outset, *Amara* presents the problem of what remedy is available for a defective Summary Plan Description ("SPD"). Thankfully, the Supreme Court rejected the District Court's analysis suggesting that plan sponsors are bound by incorrect SPD terms. The SPD provides clear, simple communication about the plan; it is not part of the plan. As a result, the courts cannot rely on defective SPD statements to reform the plan itself.

Notwithstanding this conclusion, the Supreme Court declared that the *Amara* participants are entitled to "equitable relief" under ERISA Section 502(a)(3). Such relief includes affirmative and negative injunctions to compel compliance with the plan's written terms as well as applicable law, including: (i) "reformation" of the terms of the plan, in order to remedy the false or misleading information CIGNA provided; (ii) "estoppel," or essentially holding the plan to what it promised by safeguarding "fair dealing and rebuke of all fraudulent misrepresentations;" and (c) an award of "compensation," meaning monetary amounts to rectify the loss and prevent unjust enrichment. Lastly, the Supreme Court opined that, although the plaintiffs had to show actual harm, it was not necessary for the participants to prove "detrimental reliance" in order to obtain these types of equitable relief.

In the wake of *Amara*, executives charged with overseeing credit union benefit plans should recognize that the authority of the federal courts to remedy participant claims is more expansive than previously thought. While plan provisions and related documents should be interpreted in light of the new scope of available relief, the decision also affects settlement options in the event of litigation. Further, credit unions should be mindful in preparing participant correspondence and communications that equitable forms of relief, like reformation and compensation, may be possible. While the meaning of "equitable relief" under ERISA continues to evolve, credit union executives should take reasonable precautions based on *Amara*.

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CUEd In is not intended to provide legal advice with respect to any particular situation and no legal or business decision should be based solely on its content.

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