

MEMORANDUM TO CLIENTS

December 2, 2008

RE: PPA May Restrict Rabbi Trust Funding

Public companies could effectively be prohibited from funding nonqualified plan benefits for certain executives through a rabbi trust (or otherwise) under a provision in the Pension Protection Act of 2006 (the "PPA"). Specifically, funding for top executives may need to cease if any qualified defined benefit plan in a company's controlled group is considered "at risk" under the PPA rules. While the IRS has yet to issue any guidance on this rule under Code section 409A(b)(3), a Treasury official recently confirmed informally that companies need to be in good faith compliance with the rule at this time. We summarize below the requirements of section 409A(b)(3).

Funding Restriction

If a qualified defined benefit plan is "at risk," amounts set aside in a trust or other arrangement to pay nonqualified plan benefits for certain executives must be included in the executives' income, and the executives must also pay a 20% penalty tax on this amount and interest. The affected executives are those employed by the company with the "at risk" plan or by a member of its controlled group, and who are subject to either (a) the \$1 million deduction cap under Code section 162(m) or (b) the requirements of section 16(a) of the Securities Exchange Act of 1934 (*i.e.*, officers, directors, and 10% owners). Former employees who were covered under one of these sets of rules when they terminated employment are also covered.

A plan is generally considered to be "at risk" for a plan year under the PPA rules if the plan's funding target attainment percentage ("FTAP") for the preceding plan year was less than 80%, and less than 70% with certain additional actuarial assumptions. There are transition rules for 2008 to 2010, with an FTAP of 70% used in 2009 to determine at risk status. The FTAP is the ratio of plan assets to the plan's funding target. We recommend that plan sponsors consult their actuaries for definitive information on the "at risk" tests.

Application to Public Companies

Public companies typically maintain nonqualified deferred compensation plans for their officers. Often assets are set aside on a regular basis to fund those benefits, typically through the use of a rabbi trust. (It is unclear if funding through "COLI" alone would be subject to these restrictions.) Employers with these types of nonqualified plans need to know promptly if they have an at risk plan and need to stop these automatic asset set asides.

Since these rules apply on a "controlled group" basis (generally based on an 80% ownership threshold), the at risk status of a subsidiary plan can affect funding for the nonqualified plan benefits of employees of a publicly traded parent company. Therefore, a

public company should not only be concerned about the funding of its own qualified plans, but also those maintained by other companies in its controlled group.

Effective Date

Although the PPA states that the restriction under new section 409A(b)(3) is effective for assets set aside after August 17, 2006, a plan could not have been at risk under the relevant PPA provisions until plan years beginning on or after January 1, 2008. Further IRS guidance will be needed on various timing issues under these rules, but it appears likely that the earliest that penalties could apply is for asset set asides on or after January 1, 2008.

* * *

Please call one of the following, or the Groom attorney you regularly contact, if you have any questions about this memorandum.

Eric Cotts	emc@groom.com	(202) 861-6616
Liz Dold	etd@groom.com	(202) 861-5406
Gene Fowler	edf@groom.com	(202) 861-6651
Jeff Kroh	jwk@groom.com	(202) 861-5428
Lou Mazawey	ltm@groom.com	(202) 861-6608
John McGuinness	jfm@groom.com	(202) 861-6625
David Powell	dwp@groom.com	(202) 861-6600
Kara Soderstrom	kms@groom.com	(202) 861-1129
Bill Sweetnam	wfs@groom.com	(202) 861-5427
Brigen Winters	blw@groom.com	(202) 861-6618