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BENEFITS BRIEF

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Plaintiff Goes Down to Georgia ... Court Rules in Favor of Employer Paying Nonqualified Plan Benefits as Lump Sum on Plan Termination

A federal district court recently granted an employer's motion to dismiss a claim for benefits on the ground that the satisfaction of annuity benefits under a nonqualified retirement plan with a lump sum payment does not adversely affect a participant's benefit. Taylor v. NCR Corp., No. 1:14-cv-2217-WSD (N.D. Ga. Sept. 23, 2015). In the case, the employer terminated its nonqualified retirement plan and replaced the participant's monthly benefit payable as a joint and survivor annuity with a single, actuarial equivalent lump sum payment. In its decision, the court agreed with the employer that the tax consequences of benefit payments are not part of the accrued benefit protected by ERISA. This case, while only at a district court level, is helpful to employers who intend to terminate their nonqualified plans by paying out the full value of the benefits as lump sum payments to the participants.

Employers frequently review their benefit offerings, and at times may determine to terminate certain plans. In recent years, many employers have terminated defined benefit plans, including nonqualified defined benefit plans, as part of a "derisking" strategy. For nonqualified retirement plans, an employer's ability to make changes is typically limited by its retained right to amend or terminate the plan, relevant contract principles, and limitations imposed by Internal Revenue Code Section 409A.

Amending Plan Terms

Typically, employers retain a right to amend or terminate their nonqualified retirement plans, subject to certain limitations. Usually the amendment or termination limitations are intended to prevent an employer from forfeiting or reducing the benefit to which the participant is already entitled. The wording of any limitations to the employer's right to amend or terminate the plan is critical. In Taylor, the limitation on the employer's right to amend the plan appeared to broadly apply, as an amendment could not "adversely affect" a participant's accrued benefit. Even so, the court still thought that changing the payment from an annuity to a present value lump sum payment did not adversely impact the participant's benefits. The court held that "the tax consequences are not part of an accrued benefit under ERISA." In taking this position, the court looked to six circuit court cases for support that an adverse tax impact is not a basis for an ERISA remedy for a claim for benefits.

Unilateral Contract Principles

Courts have applied general contract principles when determining if the terms of a

nonqualified plan are breached. Although ERISA's vesting rules do not apply to nonqualified retirement plans for a select group of management, many / most courts have applied a unilateral contract theory to such plan benefits once all prerequisites have been satisfied (*i.e.*, once the executive performs the requested service, the employer is obligated to comply with its side of the bargain). Those courts would apply the unilateral contract theory unless a specific plan provision allows for a subsequent change. As such, a change in the form of benefits after the participant has earned the right to the benefits may breach the terms of the contract, and thus give rise to a claim for benefits or perhaps equitable relief, unless the plan otherwise allowed for the later change.

In Taylor, the court held that the plan had expressly reserved the right of the employer to amend the plan, and the plaintiff had not disputed the employer's right to make such a change.

Code Section 409A

In Taylor, the employer terminated the nonqualified retirement plan effective February 25, 2013, and made the lump sum payment at issue on April 25, 2014. The timing of the plan termination payment would be consistent with the plan termination requirements of Code Section 409A, including: (1) the plan termination cannot be proximate to a financial downturn of the employer, (2) all nonqualified plans or other arrangements of the employer (and all members of its controlled group) of the same type must be terminated, (3) no payments can be made within 12 months of the irrevocable action to terminate the plan other than those payable as if the termination had not occurred, (4) all payments are made within 24 months of the irrevocable action to terminate the plan; and (5) the employer (and all members of its controlled group) may not adopt a new plan of the same type within three years of the irrevocable action to terminate the plan.

Considerations for Employers

To avoid unnecessary litigation with its executives and former executives, careful planning and preparation for terminating a nonqualified retirement plan (*e.g.*, as part of a derisking strategy) is advisable.

First, an employer should ensure that the nonqualified retirement plan document allows the employer the right to amend or terminate the plan. If the plan document does not allow the employer to make such changes, or severely limits those changes, the employer should consider revising the plan, and obtaining participant consent to these changes as necessary.

Next, when terminating a plan, an employer should be aware of the potential areas of concerns for participants. In addition to the change in payment time (and related tax consequences), determining the present value of the benefit is also an area that is frequently litigated (*i.e.*, the participant believes the lump sum value is understated or miscalculated). Although not always possible, there may be ways to mitigate or address some concerns (*e.g.*, the employer could split the plan termination payments between two tax years to address certain tax timing concerns).

The employer should always ensure any termination of a nonqualified retirement plan subject to Code Section 409A is done in a manner that complies with the Code Section 409A requirements. The requirements are complicated and may impact other benefit arrangements besides the plan intended to be terminated. Discussing the process with counsel is strongly advised to avoid mistakes. Failing to follow those rules can result in significant additional taxes to impacted executives, who will likely seek recourse from the company if there is a mistake.

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