KING & SPALDING

Compensation and Benefits Insights

July 28, 2011

Compensation and Benefits Insights

The Supreme Court's Ruling in *CIGNA Corp. v. Amara*

Authors, *Laura R. Westfall*, New York, +1 (212) 556-2263, lwestfall@kslaw.com and *Eleanor Banister*, Atlanta, +1 (404) 572-4930, ebanister@kslaw.com.

In *CIGNA Corp. vs. Amara*, 131 S.Ct. 1866 (U.S. 2011), the U.S. Supreme Court addressed the issue of whether pension plan participants were entitled to equitable relief under the Employee Income Security Retirement Act of 1974 ("ERISA") as a result of misleading benefit summaries. The Supreme Court held that because the benefit summaries were not part of the plan's terms, the participants could not obtain relief under Section 502(a)(1)(B) of ERISA, which provides for enforcement of plan terms. However, the Supreme Court left unresolved whether equitable relief might be available for such misrepresentations under another section of ERISA, Section 502(a)(3).

Facts

CIGNA Corporation ("CIGNA") sponsored the CIGNA Pension Plan (the "Pension Plan"), a defined benefit pension plan in which Janice C. Amara and other CIGNA employees (the "Plaintiffs") participated. Prior to January 1, 1998, the Pension Plan provided a final average pay formula benefit based on each participant's average salary and years of service. In November 1997, CIGNA froze benefit accruals under the Pension Plan, and sometime in 1998, CIGNA converted the Pension Plan to a cash balance formula, effective January 1, 1998. As part of the conversion, CIGNA made an initial credit to each participant's account supposedly equal to the present value of the participant's accrued benefit under the Pension Plan as of December 31, 1997. Thereafter, CIGNA would make annual pay credits to each participant's account based on the participant's age, length of service, and other factors. Each account would also be credited with interest credits. At retirement, each participant would receive the value of the individual account balance as a lump sum or an equivalent annuity.

CIGNA communicated the Pension Plan conversion to participants in a variety of ways in 1997 and 1998, ranging from company newsletters to summary plan descriptions (together, the "Summaries"). In 2001, the Plaintiffs filed a suit against CIGNA and the Pension Plan claiming that CIGNA had failed to adequately disclose the changes made in connection with the Pension Plan's conversion to a cash balance plan, as required by ERISA. For example:

-
    - The Summaries stated that the initial credit made to each participant's cash balance account would "represent the full value of the benefit" the participant would have received under the old Pension Plan as of January 1, 1998, even though the conversion did not account for the subsidized early retirement benefit most participants had under the old Pension Plan.

    - The Summaries stated that participants would "see the growth in [their] total retirement benefits from CIGNA every year," but in fact, the changes made by the conversion could have entitled participants to a smaller benefit under the cash balance formula than he or she would have received under the old Pension Plan, so participants might see no "growth" in the total retirement benefit for several years after the conversion.

In 2008, the U.S. District Court for the District of Connecticut held that CIGNA had not satisfied the disclosure requirements of ERISA and that the Plaintiffs were "likely harm[ed]" as a result. The District Court then reformed the Pension Plan to provide participants with the sum of the benefit they would have been entitled to receive under the old Pension Plan as of January 1, 1998, plus the benefits they were to earn under the cash balance formula from 1998 onward. The District Court relied on ERISA Section 502(a)(1)(B) to justify the reformation. ERISA Section 502(a)(1)(B) gives a plan participant the right to "recover benefits due to him under the terms of his plan, to enforce his rights under the terms of the plan, or to clarify his rights to future benefits under the terms of the plan." On appeal, the Second Circuit affirmed the District Court's holding.

CIGNA appealed to the Supreme Court, which granted certiorari to review the issue of whether the District Court had applied the correct standard ("likely harm") in holding that the participants had experienced sufficient injury to warrant relief under ERISA.

The Supreme Court's Holding

In the majority opinion (written by Justice Breyer, joined by Justices Roberts, Kennedy, Ginsburg, Alito and Kagan), the Supreme Court held that the remedy available under ERISA Section 502(a)(1)(B) is limited to "enforcement" of a plan's terms, and that plan summaries are not the same as plan terms. The Supreme Court gave a number of reasons why plan summaries do not establish the terms of a plan, including the fact that it would frustrate the purpose of providing a summary. The Supreme Court noted that benefit summaries should provide a clear and simple summary of the plan's terms, and that if those summaries were the same as plan terms, plan administrators might have to "sacrifice simplicity and comprehensibility in order to describe plan terms in the language of lawyers." The concurring opinion (written by Justice Scalia, with Justice Thomas joining) agreed with only this part of the holding.

The majority of the Supreme Court went on to conclude that relief might instead be available under ERISA Section 502(a)(3), which allows participants to obtain "other appropriate equitable relief." The majority opinion mentioned three traditional equitable remedies that might be available to the Plaintiffs under ERISA Section 502(a)(3), depending on whether the Plaintiffs met the standard of harm required by the various remedies: reformation of the plan, estoppel and surcharge. The Supreme Court remanded the case to the District Court to determine whether an appropriate equitable remedy is available to the Plaintiffs under ERISA Section 502(a)(3).

Implications for Employers

The Supreme Court's majority opinion seems to contradict itself. On the one hand, the Supreme Court clearly stated that benefit summaries are not part of a plan's terms, and therefore relief is not available under ERISA Section 502(a)(1)(B). On the other hand, the majority opinion clearly suggests that relief might be available for misrepresentations of the plan's underlying terms in a benefit summary under ERISA Section 502(a)(3). As a result, in order to avoid misrepresentation in a benefit summary, an administrator may be forced to provide more detail in summarizing the terms of the plan, which may "defeat the fundamental purpose of" the benefit summary. The majority of the Supreme Court, as well as the District Court and the Second Circuit, were clearly concerned about plan administrators providing misleading or inaccurate information to plan participants. Accordingly, plan administrators should continue to be vigilant in providing complete and accurate summaries of plan terms. As always, King & Spalding is happy to provide you guidance in reviewing or drafting plan communications.

New Proposed 162(m) Regulations Unexpectedly Limit IPO Transition Rule

Authors, *Donna W. Edwards*, Atlanta, +1 (404) 572-2701, dedwards.com and *Kenneth A. Raskin*, New York, +1 (212) 556-2162, kraskin@kslaw.com.

On June 23, 2011, the IRS issued proposed regulations under Internal Revenue Code Section 162(m) relating to the $1 million deduction limit for certain employee compensation paid by a publicly-held company. If finalized in their current form, the proposed regulations would contradict the current IRS guidance related to the treatment of restricted stock units ("RSUs") and phantom stock under the transition rule for companies undergoing an initial public offering ("IPO"). In addition, the proposed regulations reinforce that plans utilizing the Code Section 162(m) exception for "qualified performance-based compensation" with respect to stock options and stock appreciation rights ("SARs") must specify the maximum number of shares with respect to which options or SARs may be granted to each individual employee during a specified period.

Code Section 162(m) limits a publicly-held company's deduction for a "covered employee's" compensation to $1 million per year, unless the compensation comes within an exception under these rules. "Covered employees" are a publicly-held company's CEO and three highest paid employees (other than the CFO).

Transition Rule for Companies Undergoing an IPO

Under a transition rule under the current Code Section 162(m) regulations, the $1 million deduction limit does not apply to compensation paid under a plan that existed while a company was not publicly held, provided that the prospectus accompanying the company's IPO disclosed information concerning the plan that satisfied all applicable securities laws. The regulations provide that the company may rely on this transition rule until the expiration of a "reliance period" that can extend until the first shareholders meeting to elect directors that occurs after the third calendar year following the year of the IPO.

The current regulations also provide that if a stock option, SAR or restricted property award (which does not otherwise satisfy the qualified performance-based compensation exemption) is *granted* on or before the end of the reliance period, then compensation received upon the exercise or vesting of the award is also exempt, regardless of when the award is *exercised or vests*. For example, such a stock option granted in the year after an IPO with a typical 10-year term may be exercised after the expiration of the reliance period and still be exempt under this rule.

In the preamble to the proposed regulations, the IRS stated that practitioners have asked whether compensation payable under an RSU or phantom stock arrangement is eligible for this relief granted to options, SARS and restricted property. The IRS noted that the preamble to the final Code Section 162(m) regulations issued in 1994 specifically discussed that the special rule applicable to options, SARS and restricted property did not extend to cover "other stock-based compensation and deferred compensation." Thus, the proposed regulations provide that only compensation attributable to stock options, SARs and restricted property is covered under this rule, and that compensation payable under an RSU or phantom stock arrangement must be paid on or before the end of the reliance period. For example, an RSU award (which does not otherwise satisfy the qualified performance-based compensation exemption) granted in the year after an IPO must be settled on or before the end of the reliance period to be exempt under the IPO transition rule.

The IRS stated in the preamble that the proposed regulations are not intended to substantively change the current regulations. However, the conclusion reached in the proposed regulations is at odds with two Private Letter Rulings ("PLRs") issued by the IRS in 2004. These rulings provided that compensation paid pursuant to RSUs granted during, and paid after, the reliance period was not subject to the $1 million limit. While a PLR is technically only applicable to the taxpayer receiving the PLR, the guidance provided in these PLRs gave comfort to practitioners that RSUs would be accorded the same transitional relief treatment as options, SARs and restricted property.

The proposed regulations' changes to the IPO transition rule will apply on and after the date the related final regulations are published. Given the departure by the IRS from the holdings of the PLRs, we hope that the proposed regulations will be applied only to grants made following the finalization of the proposed regulations. However, it may be that the rules, once finalized, will apply to existing grants of RSUs and phantom stock arrangements, and these existing grants may be scheduled to be paid after the end of a company's reliance period. Unfortunately, there may be significant obstacles to accelerating the payment of previously granted RSUs or phantom stock arrangements to come within this deadline if they are subject to Code Section 409A.

Any pre-IPO or newly-public clients granting RSUs or phantom stock awards will need to make sure the awards will be settled or paid on or before the end of the reliance period or will satisfy the requirements to be qualified performance-based compensation.

Maximum Share Limitation

Code Section 162(m) excludes qualified performance-based compensation from the $1 million limit. The current regulations provide that stock options and SARs generally are deemed to be qualified performance-based compensation if certain requirements are satisfied, including that the plan under which the option or SAR is granted states the maximum number of shares with respect to which options or SARs may be granted during a specified period to any employee.

Some practitioners have taken the view that an aggregate limit on the shares that may be issued *under the plan during its term* could also serve to satisfy this requirement of a maximum limit on shares with respect to which options or SARs may be granted during a specified period to any employee.

The proposed regulations clarify that the plan under which the option or SAR is granted must specify the maximum number of shares with respect to which options or SARs may be granted to any *individual* employee during a specified period. Thus, if a plan states an aggregate maximum number of shares that may be granted during the term of the plan, but does not contain a specific per-employee limitation on the number of options or SARs that may be granted, then any compensation attributable to the stock options or SARs granted under the plan is not qualified performance-based compensation.

The proposed regulations further clarify that a plan satisfies this requirement where the terms of the plan specify that an individual employee may be granted options or SARs to receive the maximum number of shares authorized under the plan during a specified period.

Thus, clients should ensure that future plans are drafted with both an aggregate number of available shares and a separate limit on individual grants.

The clarifications in the proposed regulations to the maximum share limitation apply on and after June 24, 2011.

King & Spalding would be happy to assist you with any questions you may have about the proposed regulations.

The preamble to the proposed regulations describes an RSU as a right to an amount based on the value of the employer's stock, and which is payable in cash, shares of the stock, or other property, following the satisfaction of a specified vesting condition. In addition, the preamble describes compensation payable under a phantom stock arrangement as compensation that is paid at a future date in cash or in property based on the value of the employer's stock.

See PLR 200406026 (February 6, 2004), and PLR 200449012 (December 3, 2004).

Compensation and Benefits Insights – Editor:

Kenneth A. Raskin
Chair of the Employee
Benefits & Executive
Compensation Practice
kraskin@kslaw.com
+1 212 556 2162