

UNITED STATES OF AMERICA

BEFORE THE NATIONAL CREDIT UNION ADMINISTRATION

In the Matter of

XXXXXXXXXX

Docket No. BD 8 -12

Creditor Claim
XXXXXXXXXXXX Federal Credit Union

Decision and Order on Appeal

Decision

This matter comes before the National Credit Union Administration Board (Board) pursuant to §709.8 of NCUA Regulations (12 C.F.R. §709.8), as an appeal of the decision by the Agent for the Liquidating Agent for XXXXX Federal Credit Union (XXXXXX) regarding related creditor claims filed by XXXXXXXXXXXXXXXX (Claimant).

Background and Initial Determination

Claimant had been president and chief executive officer of XXXXXX from July 2004 until September 2010. On September 24, 2010, NCUA placed XXXXXX into conservatorship and put Claimant on administrative leave. On September 28, 2010, the sub-agent for the conservator repudiated XXXXXX's 457(b) Plan (457 Plan). On the next day, the sub-agent wrote to Claimant and notified him that the conservator had elected to repudiate his Employment Agreement (Agreement). In the same letter, the sub-agent notified Claimant that his employment was terminated. The letter specified that both the repudiation and the termination were "effective immediately." XXXXXX was liquidated on November 30, 2010.

Claimant and XXXXXX entered the Agreement effective on July 1, 2007. The Agreement provided Claimant with an annual salary of \$267,141 over its five-year term. It also specified that Claimant would receive health insurance coverage, use of a company car, and severance pay equal to 1.5 times his annual salary in the event of termination before the end of the term other than for cause. In addition, the Agreement specified that Claimant was eligible to participate in the 457 Plan, by which Claimant was allowed to defer a specified percentage of his compensation. As of the date of conservatorship, \$62,284 had accrued to Claimant's account pursuant to the 457 Plan.

In February 2009, as a result of the U.S. financial crisis, NCUA required each of the 27 corporate credit unions, including XXXXXX, to enter Letters of Understanding and Agreement (LUA) with the agency. These LUAs, which were identical, required the corporates to obtain NCUA's approval before making any changes to compensation arrangements for senior level executives. By letter of October 29, 2009, XXXXXX proposed to amend the Agreement by reducing Claimant's compensation and benefits. The proposal included a reduction in Claimant's overall salary and a reduction in the scope and extent of severance, including reduced health care coverage during the severance period. It also contained certain other modifications, all of which were to Claimant's financial detriment.

Claimant has asserted that he voluntarily initiated these reductions in recognition of the threats to XXXXXX's financial condition, and that they represented Claimant's willingness to make personal financial sacrifices to reduce expenses for XXXXXX, rather than require the rank and file staff to bear these burdens. By reducing his severance entitlement, Claimant stated that he intended to conform the Agreement to the limits that were, at that time, being proposed by NCUA in changes to the corporate rule (Part 704), which called for severance arrangements not to exceed 12 months' salary. By letter of November 4, 2009, NCUA's Director of its Office of Corporate Credit Unions (OCCU) advised XXXXXX of his approval of the proposed changes.

Claim.

There are two primary components of Claimant's appeal. The first, involving the 457 Plan, challenges the Liquidating Agent's classification of Claimant's deferred compensation claim as a general creditor claim. Claimant asserts that the terms of the deferred compensation plan specified that his claim to the amount in his account had become "non-forfeitable (vested)" upon the appointment of the conservator. Claimant accordingly asserts that the funds in his account became his property at that time and that the Liquidating Agent had no right to withhold payment to him of the entire balance. In the alternative, Claimant argues that the claim should have been accorded the relatively higher level 2 priority in the liquidation (available to claims for wages) instead of the level 5 priority accorded general creditor claims. See 12 C.F.R. §709.5(b).

The second component of Claimant's appeal involves severance under the Agreement, as amended. Claimant asserts that his termination was without cause, giving rise to a contractual right to receive severance totaling \$160,285 and health insurance coverage for a period of nine months at \$1,890 per month, for a total severance claim of \$177,294. The Liquidating Agent outright rejected this component of the claim, asserting that severance does not qualify as an element of "actual, direct, compensatory damages" that can be claimed against a liquidation estate. See 12 U.S.C. §1787(c)(3).

Claimant has also sought recovery of reasonable attorney's fees and interest on the claim amounts.

Applicable Legal Standard.

The Federal Credit Union Act (FCU Act) vests the conservator or Liquidating Agent with authority, within a reasonable time following its appointment, to repudiate any contract the performance of which it determines to be burdensome if, in the judgment of the conservator or Liquidating Agent, repudiation will promote the orderly administration of the credit union's affairs. 12 U.S.C. §1787(c). In this case, following the date of conservatorship, NCUA determined it no longer needed Claimant's services as CEO. Repudiation of both the 457 Plan and the Agreement was, accordingly, appropriate under the circumstances.

Claimant has voiced vigorous objection to the conservator's decision to repudiate the Agreement. In Claimant's view, the fact that NCUA reviewed and approved the voluntary reductions to his compensation arrangements, as evidenced by OCCU Director Hunt's letter of November 4, 2009, should have precluded NCUA from repudiating those arrangements following the appointment of the conservator. In Claimant's view, Director Hunt's approval signified formal, comprehensive agency action that cannot be withdrawn or rescinded. In support of his position, Claimant has cited several cases in which courts have prevented the government from changing its position in various contexts.

Claimant has failed, however, to recognize or acknowledge the different capacities that NCUA fulfilled in this case. In its capacity as regulator, it was appropriate for NCUA, acting through the Director of OCCU, to review and approve the adjustments made to the Agreement. In its statutorily recognized, separate capacity as conservator, NCUA has an entirely different perspective and a different set of responsibilities. Courts have recognized these separate capacities in cases involving the FDIC, which has a statutory mandate similar to NCUA and acts as both regulator and liquidator. See *FDIC v. Bernstein*, 944 F.2d 101, 106 (2d Cir.1991) (“[T]he wrongful conduct attributed to the FDIC as corporation cannot be attributed to the FDIC as receiver.”); see also *McCarron v. FDIC*, 111 F.3d 1089, 1097 (3d Cir. 1997) (in which the court refused to find equitable estoppel against FDIC in its capacity as receiver, concluding that the claimant had not established that FDIC had represented he would be able to collect severance payments in the event of liquidation).

In accordance with the FCU Act, the conservator is not liable for damages for contract repudiation, except for certain actual direct compensatory damages. 12 U.S.C. §1787(c)(3). The FCU Act limits the liability of the conservator for other damages. 12 U.S.C. §1787(c)(3)(B)(ii). It does not further define “actual direct compensatory damages,” but there are several court cases involving failed banks interpreting this language (which is also contained in the Federal Deposit Insurance Act) in matters in which the FDIC or the Resolution Trust Corporation (RTC) was acting in a capacity similar to that of the conservator.

In this case, the Liquidating Agent determined that the balance in Claimant's deferred compensation account under the 457 Plan was a legitimate, allowable component of

actual damages. Accordingly, Claimant's challenge with respect to this issue is the priority level that the Liquidating Agent provided the claim. With respect to the severance claim, the Liquidating Agent determined that severance was not an allowable component of actual damages and so rejected the claim outright. Claimant challenges that determination. Each of these elements is discussed below.

Discussion and Analysis.

457 Plan. Claimant argues strenuously that the conservator acted improperly by not simply transferring the balance in his 457 Plan account directly to him immediately following its appointment. Claimant correctly points out that the terms of the 457 Plan specify that, upon the occurrence of a change of control (defined to include an event like conservatorship), Claimant shall have a "non-forfeitable (vested) right" to 100% of the balance in his account. Claimant asserts that this language should be interpreted to mean that title to the funds in his account transferred to him upon the effectiveness of the change in control.

Claimant has mischaracterized the nature of the 457 Plan. Under the law, such plans are available to certain government and non-profit organizations as a vehicle by which participating employees may successfully defer receipt of earned income and thereby avoid the payment of income taxes on those earnings. 26 U.S.C. §457(b). Such plans are typically characterized as "non-qualified," which simply means they are not designed to be in compliance with all of requirements of the Employee Retirement Income Security Act (ERISA). ERISA imposes several stringent requirements on qualified plans, such as pension and profit sharing plans, but the usual 457 plan does not typically meet those requirements. Consequently, the only way in which income associated with such plans can legally be deferred, and taxes thereon avoided, is if the assets of the plan are not segregated from the employer's general assets and remain subject to the claims of general creditors of the sponsoring employer. 26 U.S.C. §457(b)(6).

In a 5th Circuit case involving the RTC and a Supplemental Executive Retirement Plan (SERP)¹ maintained by a thrift that had become insolvent, the court specifically noted that participants in the plan had the status of general creditors. *See McAllister v. Resolution Trust Corp.*, 201 F.3d 570, 575 (5th Cir. 2000) ("In accordance with the mandates of the Internal Revenue Code, the SERP agreement requires that in the event of insolvency all SERP assets be available to pay the thrift's creditors."). The 457 Plan involved in this case was explicitly designed in this way, and by its terms is expressly characterized as an "unfunded" plan, with the rights of participants subject to the claims of general creditors. *See, e.g.*, 457 Plan §11.1 ("this Plan is an unfunded deferred compensation plan . . . [t]he Participant has the status of an unsecured creditor of the Employer and the Plan constitutes a mere promise by the Employer"); 457 Plan §11.6 (funds in the Plan "shall continue to be subject to the unsecured general creditors of the Employer").

¹ A SERP is another type of unfunded, non-qualified plan for the deferral of income.

Accordingly, Claimant's account was subject to the claims of general creditors of XXXXXX. The fact that the 457 Plan characterized Claimant's rights in the account as "non-forfeitable (vested)" simply means that there were no other conditions or elements that Claimant had to satisfy, such as employment for a specified term of years or reaching a certain age, before becoming eligible to receive the funds. Thus, under the 457 Plan, Claimant was at all times immediately "vested" in the portion of his account consisting of his own deferred compensation, and Claimant was likewise immediately vested in any amounts that XXXXXX contributed to the account in the form of matching funds. 457 Plan, §5.1. Under the 457 Plan, XXXXXX could elect to provide additional funds in to Claimant's account, and his vesting for those funds became established upon the change in control. 457 Plan, §5.4(b). Vesting in this context, however, has no bearing on the question of whether funds in Claimant's account remained subject to the claims of creditors of XXXXXX.

Once XXXXXX was placed into liquidation, the Liquidating Agent became responsible for the administration of all creditor claims against XXXXXX. The claims process as outlined in the FCU Act is the exclusive medium through which such claims are resolved. 12 U.S.C. §1787(b)(3)(A). The Liquidating Agent has the power to determine such claims and disallow claims not proven to its satisfaction. 12 U.S.C. §1787(b)(5)(B). No creditor may use a self-help remedy or attempt to enforce a lien on its own against property of the liquidation estate. 12 U.S.C. §1787(b)(13)(C).

Claimant is, therefore, required to pursue the claims process for satisfaction of his claim. Furthermore, the Liquidating Agent has properly characterized the claim in category five under the applicable rule, which is the category that applies to general creditor claims. 12 C.F.R. §709.5(b)(5). NCUA's long-standing view is that claims payout priority category two pertains only to current wages and salaries, and does not include deferred compensation. See OGC Op. No. 05-0816 (November 18, 2005). Ascribing category five priority also conforms directly to the posture taken by AMAC in response to claims for deferred compensation asserted by several former executives at other failed corporate credit unions who were beneficiaries of 457 plans sponsored by those institutions.²

Claimant's arguments that he is entitled to outright ownership and control of the funds in his account or, in the alternative, that the priority for his claim should be higher, are without merit.

Severance. The Liquidating Agent's letter rejecting Claimant's claim for severance recites, correctly, that a split exists among the U.S. Courts of Appeal in cases involving whether claims for severance can be maintained against the estate of a failed bank under the damages limitation statute. In three circuits, the reviewing court characterized severance as an element of the bargained-for consideration underlying the employment contract. Using that characterization, these courts reasoned that, following repudiation

² The plan in one such case was administered under §457(f), not (b), but that distinction is immaterial to the question of whether participant rights in such plans are the equivalent of general creditor claims against the conservatorship estate.

of the contract by the conservator or receiver, the contractually specified amount of severance is an element of compensation and failure to pay it constitutes an actual contractual damage that is recoverable against the liquidation or conservatorship estate. See *Office & Professional Employees International Union, Local 2 v. FDIC*, 27 F.3d 598, 604 (D.C. Cir. 1994) (“*OPEIU*”); *Monrad v. FDIC*, 62 F.3d 1169 (9th Cir. 1995); *McMillian v. FDIC*, 81 F.3d 1041 (11th Cir. 1996).

Another way of viewing this line of cases, as articulated in a 1993 District Court case involving FDIC, is that the contractual commitment to pay severance had become established upon the execution of the contract and thus could not be repudiated without giving rise to actual damages. In that case, the judge noted that “to have any meaning, a promise for severance benefits must vest at the moment the parties finalize their agreement. The very purpose of the severance provision was to protect [the claimant] from the type of events which transpired at [the failed bank] in the summer of 1992. [The claimant’s] right to the \$160,000 severance payment vested the day he and [the failed bank] reached their agreement.” *LaMagna v. FDIC*, 828 F. Supp. 1, 2-3 (D.D.C. 1993).

Appellate courts in three other federal judicial circuits have characterized severance as more analogous to liquidated damages. These courts viewed the contractual provisions for severance as an attempt by the parties to estimate what the employee’s actual damages would be, since precise calculation is difficult. In this light, because an employee could be either better or worse off for having remained with an employer, severance amounts are more properly considered an attempt to agree in advance on what damages the employee would be entitled to receive in the event of breach. This is the traditional purpose of a liquidated damages contractual provision. Following this reasoning, these courts have held that the severance amount is not an “actual” or “direct” contractual damage, and so may not be claimed against a conservator or receiver. See *Howell v. FDIC*, 986 F.3d 569 (1st Cir. 1993) (“actual direct compensatory damages does not include severance payments stipulated in advance”); *Hennessy v. FDIC*, 58 F.3d 908 (3d Cir. 1995); *RTC v. Management, Inc.*, 25 F. 3d 627, 632 (8th Cir. 1994) (“Neither severance fees nor future lost profits are compensable under FIRREA”).

Courts that have allowed severance claims to be maintained have focused on the at-will nature of the employment contracts at issue in those cases. In *OPEIU*, the D.C. Circuit rendered a considered opinion of the relationship between the parties and found that “the at-will relationship means that severance payments are properly characterized as consideration for entering into (or continuing under) the employment contract and therefore are compensable as actual damages under FIRREA.” *OPEIU, supra*, at 604. The 9th Circuit expressly adopted this view. *Monrad, supra*, at 1174 (“This court concludes that *OPEIU* offers the better-reasoned approach”).

The *McMillian* case also involved an at-will employment relationship, and this distinction seemed to be important in the holding. Since the contract was at-will, “the termination of . . . employment did not, by itself, breach a contract.” *McMillian, supra*, at 1054.

Instead, the court noted that the severance package appeared to be part of McMillian's compensation rather than liquidated damages. *Id.* Noting that employees became eligible for severance two years after beginning employment, and that severance increased with seniority, the court found

the increase of benefits based on seniority . . . [to be] inconsistent with the concept of liquidated damages. The years of employment would not be relevant to an estimation of the damages which an employee might incur as a result of being terminated. Instead, the fact that severance pay increases with seniority supports McMillian's position that it was part of his compensation.

Id. (internal citations omitted). By contrast, Claimant's employment arrangement with XXXXXX was for a term of years. Under normal contract principles, if Claimant had been terminated without cause, he would have been entitled to damages for the remainder of the contract, less any amounts he could have realized through mitigation. This relationship is distinct from an at-will employment arrangement, in which either party has the right to terminate the relationship for any reason, or no reason, at any time. Furthermore, unlike the *McMillian* case, the amount of severance available to Claimant became fixed upon the execution of the Agreement. There was no variation based on the length of his service before the termination. *C.f. OPEIU, supra*, at 604 (employees who worked for the bank for more than six months but less than one year were entitled to one week of pay upon termination. Those who had worked for more than one year were to receive two weeks' pay for each year of service).

The Board recognizes the difficulty in reconciling the split in the circuits on this issue. It is clear, on the one hand, that the severance component in the Agreement was bargained for, and clearly represents an element of the consideration Claimant extracted from XXXXXX in exchange for his agreement to accept and remain in the position of CEO. To that extent, it is reasonable to view the severance as earned or vested as of the date the Agreement was consummated. On the other hand, the Agreement contemplates a term of years, as opposed to an at-will relationship. As such, damages for early termination would come into play, and it does appear that the parties sought to use the specified severance amount as a shorthand estimate of those damages. To that extent, the claim amount can be characterized as other than actual damages, and therefore not recoverable against the conservator. Claimant takes the view that the analysis reflected in the *OPEIU*, *McMillian*, and *Monrad* opinions is the better-reasoned approach, and urges that the Board overturn the Liquidating Agent's initial determination.

The Board finds guidance in resolving this appeal through reference to two separate, although related indications of agency policy. In general, in cases involving claims of severance, agency policy has been to pay non-discriminatory severance arrangements that are:

- documented in the credit union's personnel policy;
- available to all employees; and

- based on objective criteria such as salary and length of service.

The Liquidating Agent typically includes this payment in the affected employee's last paycheck. Where the personnel policy or state law requires, accrued vacation and sick leave pay are also included in the final paycheck. Support for this type of treatment is based on §709.5(b)(2) of NCUA rules, which accords the relatively high category two priority for claims proven to the satisfaction of the Liquidating Agent "for wages and salaries, including vacation, *severance* and sick leave pay." 12 C.F.R. §709.5(b)(2) (emphasis added). The Board notes that the Liquidating Agent has not, as a matter of practice, adopted or followed that policy in cases involving severance claims arising from employment contracts at the senior executive level.

The position adopted by the Liquidating Agent in this case predates the adoption of rules dealing with the subject, which were formally codified after the conservatorship and liquidation of XXXXXX. The rules include provisions governing treatment of so-called "golden parachutes" and were adopted initially as part of the revisions to the corporate rule that became effective in January 2011. They are now applicable to all insured credit unions, as codified in new Part 750, which became effective in May 2011. Had those rules been in effect at the time of the conservator's repudiation determination in this case, the severance claim would have been resolved entirely and, for Claimant, unfavorably. See 12 C.F.R. §750.7 (barring claims for employee benefits that are contingent, even if otherwise vested, when a conservator is appointed). The rule is, in effect, a codification of the principles articulated in the 1st, 3rd and 8th Circuit rulings, as discussed above. The Board notes that rules adopted by the FDIC, which acts in similar capacities in the context of failed banks, reflect the identical position. 12 C.F.R. §359.7.

Accordingly, the Board adopts the Liquidating Agent's characterization of Claimant's severance claim as being in the nature of liquidated damages, and therefore not recoverable against the liquidation estate following the conservator's repudiation determination.

Interest and Attorney's Fees. In addition to the foregoing claims, Claimant has asserted that NCUA should pay him interest on the claimed amounts and attorney's fees to make him "whole." Aside from "actual direct compensatory damages," however, by law the conservator is not liable for other damages. 12 U.S.C. §1787(c)(3)(B)(ii). Furthermore, since Claimant's 457 Plan claim was initially allowed and accorded the proper liquidation priority, there is no reason Claimant would be entitled to interest on that portion of his claim. His severance claim was properly denied, and so there is nothing on which interest could accrue. Regarding attorney fees, as the 9th Circuit noted in a case involving the RTC, under federal common law the generally applicable rule is that each side pays its own attorney's fees. See *Modzelewski v. Resolution Trust Corp.*, 14 F.3d 1374, 1379 (9th Cir.1994). There is no reason that general rule should not be applied in this case.

Order

For the reasons set forth above, it is ORDERED as follows:

The appeal by XXXXXX:

- i. challenging the determination to accord general creditor status concerning his claim to funds standing in his name under XXXXXX's 457 Plan, which Plan was properly repudiated by the conservator, is denied;
- ii. challenging the Liquidating Agent's determination to deny in full his claim to receive severance benefits of \$177,294, comprised of \$160,285 in cash and \$17,010 representing costs of health insurance, following the repudiation of his employment contract by the conservator, is denied; and
- iii. seeking interest and attorneys' fees in connection with the foregoing amounts and challenges, is denied.

The Board's decision constitutes a final agency determination. Pursuant to 12 C.F.R. 709.8(c)(1)(iv)(B), this final determination is reviewable in accordance with the provisions of Chapter 7, Title 5, United States Code, by the United States Court of Appeals for the District of Columbia or the court of appeals for the Federal judicial circuit where the credit union's principal place of business was located. Such action must be filed within 60 days of the date of this final determination.

So **Ordered** this 6th day of December, 2012, by the National Credit Union Administration Board.

/S/

Mary F. Rupp
Secretary of the Board