

# Eleventh Circuit Rules on Valuation of RSUs Under Section 409A Plan

**November 29, 2010**

A recent Eleventh Circuit Court of Appeals decision concerning the valuation date of restricted stock units (“RSUs”) to be paid in cash demonstrates the importance of not just amending documents to technically comply with new legal requirements, but also to focus on the ramifications of implementing them. This client alert provides a summary of the case and its implications for employers.

***Graphic Packaging Holding Co. v. Humphrey, No. 10-12015, 2010 WL 4608775 (11th Cir. Nov. 16, 2010).***

Graphic Packaging Holding Company maintained a nonqualified stock and incentive compensation plan. Stephen Humphrey, when president and chief executive officer, was awarded RSUs that were to be paid out to him one-half in cash and one-half in shares of company stock. Additionally, payment of the awards was subject to the six-month waiting period applicable to “specified employees” under Section 409A of the Internal Revenue Code of 1986, as amended (“Section 409A”). Although the plan documents and award agreements contained other terms and conditions of participation, the awards did not specify when the RSUs were to be valued for determining the amount of cash to be paid under the cash portion of the RSUs.

The executive retired on December 31, 2007, and on that date he was a “specified employee” for purposes of Section 409A. Consequently, payment of his RSUs was subject to the Section 409A six-month waiting period and payable on June 30, 2008. On June 30, 2008, the company paid the executive approximately \$1.2 million for the cash portion of his RSUs, representing the value of the RSUs on the date of the executive’s retirement (i.e., December 31, 2007). However, after a review, the company concluded that the valuation should have been made as of June 30, 2008, the date of distribution, instead of the separation from service date. In the interim, the stock had decreased in value. As a result, the company maintained that the executive was overpaid by over \$540,000 due to an “administrative error.” Settlement in shares, of course, does not have the same valuation issues and withholding would be based on the value at the time of distribution.

The executive refused to return the overpayment to the company. After several attempts to obtain reimbursement, the company sued. The district court held in favor of the former employee because the company “failed to produce sufficient evidence showing that valuing the RSUs on the date of [the executive’s] retirement was a mistake.”

On appeal, the Eleventh Circuit upheld the judgment in the executive’s favor. Although the appellate court agreed that the company’s views on when the valuation should have been done were reasonable, it was troubled by a “notable” omission from the company’s arguments – namely, that the company could not point to any plan language mandating that the RSU value was to be determined as of the distribution date instead of the separation from service date. The Eleventh Circuit further noted that nothing in Section 409A suggests that the proper valuation date would be at the expiration of the six-month waiting period. Accordingly, the Eleventh Circuit upheld the district court’s decision as it found that the company did not produce sufficient evidence supporting the position that the valuation of the RSUs on the separation from service date was incorrect, and that because “recovery” of amounts was involved, the burden had shifted to the company.

### **Implications of the Case**

The *Humphrey* case serves as a reminder to employers to review the language in their plans and grants to ensure that its terms and conditions reflect and expressly state the company’s intent. In particular, many nonqualified deferred compensation plans subject to Section 409A added the Section 409A six-month delay language but may not have addressed fully its implementation on existing distribution provisions. The six-month delay rule for specified employees is solely a mandated delay in the payment of deferred compensation. It does not address whether the plan should or should not credit earnings or continue to value shares during that six-month delay. There is no right or wrong answer as to which procedure on timing of valuation is preferable (and, indeed, if the value had increased rather than decreased, the parties may have taken the opposite position). The important lesson learned from this case is to address the issue in the documents and not leave it to later resolution.

The case also serves as a year-end reminder to review nonqualified plans for Section 409A compliance. Read our [client alert on Notice 2010-16 regarding the voluntary corrections December 31, 2010 deadline for Section 409A document compliance](#). Note that a plan amendment clarifying the valuation mechanics and valuation date of an award should be a permissible amendment under Section 409A as it does not affect the timing or form of payment. However, other amendments may require document correction under IRS correction procedures. Regardless of the type of amendment, however, it is crucial that plan documents conform to plan operations and legal requirements to avoid significant liability. Delaying corrections past year-end may eliminate options or limit the relief available under the correction procedures.

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