Chapter 10

Defined Benefit Plans: Funding, Termination, and Withdrawal

Nell Hennessy

Harold J. Ashner

ERISA and the Internal Revenue Code set forth detailed requirements for funding pension plans. Additional rules apply when plans are underfunded. Single-employer plans that are terminated and multiple-employer plans from which employers withdraw also must satisfy a host of rules, particularly when they are underfunded. The rules generally attempt to ensure that the employer satisfies its obligations for the pension benefits promised under a plan. This chapter addresses these issues.

Minimum Funding Requirements

Q 10:1 What are the minimum funding requirements for defined benefit pension plans?

ERISA Title I and the Internal Revenue Code (Code; I.R.C.) require pension plans to establish and maintain a funding standard account. For a plan year, the funding standard account is (1) charged with the sum of the normal costs of the plan and the amount necessary to amortize in equal annual installments unfunded past service liabilities, experience losses, changes in actuarial assumptions, waived funding deficiencies, and other items and (2) credited with the sum of employer contributions to the plan and the amounts necessary to amortize in equal annual installments decreases in unfunded past service liabilities, net experience gains, gains due to changes in actuarial assumptions, waived funding deficiencies, and other items. [ERISA §302(b); I.R.C. §412(b)]

Q 10:2 What are the fiduciary responsibilities associated with the funding of defined benefit plans?

The plan administrator retains an enrolled actuary to perform the annual funding valuation on behalf of the plan's participants and beneficiaries. [ERISA §103(a)(1)(A)(4)(A)] Plan fiduciaries may also have an obligation to collect contributions due to the plan. The enrolled actuary is generally not a plan fiduciary.

Q 10:3 May the cost of calculating minimum funding requirements be paid from plan assets?

Yes, the cost of calculating minimum funding requirements may be paid from plan assets because the plan is required to maintain the funding standard account and the plan administrator is required to retain the actuary on behalf of the plan's participants and beneficiaries.

Q 10:4 How does a plan satisfy its minimum funding standard for a plan year?

A plan must not have an accumulated funding deficiency at the end of the plan year. An accumulated funding deficiency exists for any plan year when the total charges to the funding standard account for all plan years exceed the total credits to that account for such years. [ERISA §302(a); I.R.C. §412(a)]

Q 10:5 How are the minimum funding rules applied to a multiemployer plan?

The minimum funding standards for a multiemployer plan are determined as if all participants in the multiemployer plan were employed by a single employer. [I.R.C. §413(c)(4)]

Q 10:6 When are contributions required to be paid to a plan?

Contributions to a plan (other than a multiemployer plan) with a funded current liability percentage below 100 percent for the prior plan year must be paid in four installments for the

current plan year. [ERISA §302(e)(1); I.R.C. §412(m)(1)] For a calendar-year plan, the payment dates are April 15, July 15, and October 15 of the current year, and January 15 of the next year. [ERISA §302(e)(3); I.R.C. §412(m)(3)(B)] If these quarterly contributions, together with interest, are not sufficient to satisfy the plan's minimum funding standard for the plan year, an additional contribution, sometimes called a "catch-up" contribution, must be made within 8 months after the end of the plan year (e.g., by September 15, 2006, for the 2005 calendar plan year). Any payment made for the plan year within that 8-month "grace period" is treated as if it had been made on the last day of the plan year. [ERISA §302(a), (c)(10); I.R.C. §412(a), (c)(10)] Contributions to multiemployer plans must be paid by the end of the 8-month grace period.

Q 10:7 Do underfunded plans face additional financial requirements?

Yes. Underfunded single-employer plans with more than 100 participants are subject to an additional charge called the *deficit reduction contribution* (DRC). Plans with funding ratios of 60 percent or less must fund, in the current year, 30 percent of their new liabilities. For each percentage point by which a plan's funding ratio exceeds 60 percent, the DRC amortization percentage is reduced by 0.4 percent. [ERISA §302(d)(4); I.R.C. §412(l)(4)]

Q 10:8 Which plans are subject to a DRC?

A DRC generally applies only to plans with more than 100 participants that have a funded current liability percentage of less than 90 percent. In making the threshold calculation of the funded current liability percentage, assets are not reduced by any credit balance in the funding standard account.

Q 10:9 What is the volatility rule?

There is a special *volatility rule* that exempts certain pension plans from the special DRC funding requirements for underfunded plans if they are between 80 percent and 90 percent funded. [ERISA §302(d)(1), (9); I.R.C. §412(l)(1), (9)] Under the volatility rule, a plan has no DRC for a plan year if the plan's funded current liability percentage is at least 80 percent and if the plan had been 90 percent or better funded for any two consecutive plan years out of the previous three plan years. [ERISA §302(d)(1), (9); I.R.C. §412(l)(1), (9)]

Q 10:10 Are underfunded plans subject to special restrictions?

Yes. To enhance the funding of underfunded plans, beginning for plan years after 1994, ERISA requires pension plans (other than multiemployer plans and plans with fewer than 101 participants) to comply with payment restrictions and an excise tax for liquidity shortfalls. [ERISA §302(e)(5); I.R.C. §412(m)(5)]

Q 10:11 What is a liquidity shortfall?

A *liquidity shortfall* occurs when a plan's liquid assets (i.e., cash and marketable securities) as of the last day of the quarter are less than the base amount for the quarter. The *base amount* for the quarter is an amount equal to three times the sum of the most recent 12 months' worth of disbursements from the plan. For these purposes, disbursements are all disbursements from the pension trust, including purchases of annuities, payments of single sums, and other benefits and administrative expenses.

To cure a liquidity shortfall, a plan sponsor must pay the greater of the regular quarterly contribution or the liquidity payment. The *liquidity payment* is the excess of the base amount over the liquid assets, but in no event more than is needed to increase the funded current liability percentage 100 percent. [ERISA §302(e)(5); I.R.C. §412(m)(5)]

Q 10:12 What is the penalty for failure to pay a liquidity shortfall?

If a liquidity shortfall is not cured, the plan sponsor is subject to a nondeductible excise tax of 10 percent of the outstanding liquidity shortfall. The occurrence of a liquidity shortfall for four additional consecutive quarters results in a 100 percent excise tax due on the amount of the initial liquidity shortfall. [I.R.C. §4971(f)]

Q 10:13 Are there any restrictions on plan fiduciaries during the period of a liquidity shortfall?

Fiduciaries cannot make certain payments from pension plans while the plan has a liquidity shortfall. The payments that are prohibited include the following:

1. Any payment, in excess of the monthly amount paid under a single life annuity (plus any Social Security supplement), to a participant or beneficiary whose annuity starting date occurs during any period in which the plan has a liquidity shortfall;
2. Any payment for the purchase of an irrevocable commitment from an insurer to pay benefits; and
3. Any other payment specified under regulations issued by the Secretary of the Treasury.

[ERISA §206(e)]

Note. An individual's *annuity starting date* is defined for this purpose (i.e., the limitation on the payment of benefits where there has been a liquidity shortfall) as the first day of the first period for which an amount is payable as an annuity, or in the case of a benefit not payable in the form of an annuity, as the first day on which all events have occurred that entitle the individual to the benefit. [ERISA §§205(h)(2), 206(e)(2)(A)]

Q 10:14 What is the result of an impermissible distribution during a liquidity shortfall?

If a fiduciary makes a prohibited distribution from the plan, he or she may be subject to a civil penalty for each prohibited distribution equal to the lesser of the amount of the distribution or $10,000. [ERISA §502(m)]

Q 10:15 What additional restrictions are imposed on the plan sponsors of underfunded pension plans?

Certain underfunded pension plans are prohibited from changing the actuarial assumptions used to determine current liability for a plan year without the approval of the Secretary of the Treasury. This prohibition, applicable to changes in actuarial assumptions for plan years after October 28, 1993, is not applicable to changes in interest rates and mortality assumptions. [I.R.C. §412(c)(5)(B)]

Q 10:16 Under what circumstances does a pension plan require approval of the Secretary of the Treasury to implement a change in actuarial assumptions?

The Secretary of the Treasury's approval of changes in a plan's actuarial assumptions is required in the following circumstances:

1. The plan is a single-employer defined benefit plan subject to ERISA Title IV;
2. The aggregated unfunded vested benefits of all underfunded plans maintained by the employer and members of the employer's controlled group exceed $50 million as of the end of the preceding plan year; and
3. The change in assumptions (determined after taking into account any interest rate and mortality table changes) decreases the plan's unfunded current liability for the current plan year by either (a) more than $50 million or (b) more than $5 million if the decrease is at least 5 percent of the current liability of the plan before the change.

[ERISA §302(c)(5); I.R.C. §412(c)(5)]

Q 10:17 Who is statutorily obligated to make contributions to plans subject to the minimum funding requirements under ERISA Title I and the Code?

Under Code Section 412(c)(11), the employer that maintains the plan is obligated to satisfy the plan's minimum funding obligation. Section 412(c)(11) also requires that each member of that employer's controlled group (if any) is jointly and severally liable for the minimum funding contributions. In addition, an employer may have a collectively bargained obligation to make contributions to a plan, which obligation arises under federal labor law.

[*See* International Union, United Auto., Aerospace & Agric. Implement Workers of Am. v. Keystone Consol. Indus., 793 F.2d 810 (7th Cir. 1986).]

Q 10:18 Can a shareholder be liable for the employer's obligation to contribute to the plan?

Perhaps. In *NYSA-ILA Medical & Clinical Services Fund v. Catucci*[60 F. Supp. 2d 194 (S.D.N.Y. 1999)], the applicable trust agreement provided that due and owing contributions constituted vested assets of the plan, and thus they were "plan assets" for purposes of ERISA. In this case a multiemployer benefit plan brought an action against the employer's corporate officers for their alleged role in the corporate employer's failure to make contributions to the plan. The plan had won a judgment for delinquent contributions against the corporation in a prior action, but the corporation was bankrupt. Because the plan document defined *plan assets* as including monies owed, and because the contributing employer's majority shareholder exercised managerial discretion or control over the delinquent contributions, the court concluded that the majority shareholder was a fiduciary with respect to those assets of the multiemployer plan.

Q 10:19 What is the required quarterly installment for a single-employer plan?

The required installment amount for a single-employer plan is 25 percent of the lesser of (1) 90 percent of the required minimum funding contribution for the plan year or (2) 100 percent of the required minimum funding contribution for the preceding plan year. [ERISA §302(e)(4); I.R.C. §412(m)(4)]

Q 10:20 Must a single-employer plan sponsor notify the Pension Benefit Guaranty Corporation if it fails to make a quarterly contribution or other required payment?

Yes. If the required payment to a plan (other than a multiemployer plan) is not made by the 30th day after it is due, the plan sponsor and the plan administrator are required to file a reportable event notice with the Pension Benefit Guaranty Corporation (PBGC) by that 30th day. In addition, if the total of missed contributions is sufficient to trigger a lien (see Q 10:22), the plan sponsor and the ultimate parent of the plan sponsor's controlled group must file a Form 200 with the PBGC within 10 days after the payment was due, even if the missed payment is made shortly after it is due. [ERISA §302(f)(4); I.R.C. §412(n)(4)] In either case, a timely and complete filing by or on behalf of one person required to file satisfies the obligation of any other persons required to file.

Q 10:21 Must a contributing employer in a multiemployer plan notify the Pension Benefit Guaranty Corporation if it fails to make a required contribution?

No. A contributing employer in a multiemployer plan is not required to notify the PBGC if it fails to make required contribution.

Liens

Q 10:22 Does a lien arise if a plan sponsor fails to make the statutory minimum funding contributions?

Sometimes. If the total of missed contributions (including interest) to a plan (other than a multiemployer plan) exceeds $1 million, a lien arises in favor of the plan. [ERISA §302(f); I.R.C. §412(n)] (See also Qs 10:23–10:27.)

Q 10:23 What is the amount of the lien?

The lien is equal to the required unpaid overdue contributions (including interest) for plan years beginning after 1987. [ERISA §302(f)(3); I.R.C. §412(n)(3)]

Q 10:24 What property is subject to the lien?

The lien attaches to all property and rights to property (whether real or personal) belonging to the delinquent employer and any other person who is a member of the employer's controlled group (see Q 10:34). [ERISA §302(f)(1); I.R.C. §412(n)(1)]

Q 10:25 What is the period of the lien?

The lien arises on the due date of a required installment or other payment. ERISA provides that the lien continues until the last day of the first plan year in which the plan does not have missed contributions (including interest) totaling in excess of $1 million. [ERISA §302(f)(4)(B); I.R.C. §412(n)(4)(B)]

Q 10:26 What is the status of a Section 412(n) lien?

A lien imposed under Code Section 412(n) for missed plan contributions is treated in the same manner as a federal tax lien. [ERISA §302(f)(4)(C); I.R.C. §412(n)(4)(C)] (See Q 10:69.) Yet in *In re CF&I Fabricators of Utah, Inc*. [150 F.3d 1293 (10th Cir. 1998)], the Tenth Circuit ruled that the amount of the Section 412(n) lien is not entitled to tax priority under the Bankruptcy Code.

Q 10:27 Who may enforce the lien?

The lien may be perfected and enforced only by the PBGC or, at the direction of the PBGC, by the contributing sponsor (or any member of the controlled group of the contributing sponsor). [ERISA §302(f)(5); I.R.C. §412(n)(5)] The PBGC has express authority (although the exercise of such authority is discretionary) to bring a civil action to enforce the minimum funding provisions of ERISA and the Code with respect to plans that are covered by the PBGC's guarantees, upon the occurrence of the conditions under which a lien arises. [ERISA §4003(e)(1)]

Variances

Q 10:28 Can an employer receive a variance from the minimum funding requirements under a single-employer plan?

Yes. If an employer is unable to satisfy the minimum funding standard without temporary substantial business hardship, and if the application of the minimum funding requirements would be adverse to the interests of plan participants overall, the Secretary of the Treasury may waive the minimum funding standard or any portion of it (except amounts due as a result of prior minimum funding waivers). However, the Secretary cannot grant a minimum funding waiver for more than 3 of any 15 consecutive plan years. [ERISA §303(a); I.R.C. §412(d)]

Q 10:29 Can a multiemployer pension plan obtain a minimum funding variance?

Yes. The requirements are generally the same as those for an employer under a single-employer plan, with the following exceptions:

1. Ten percent or more of the employers contributing to or under the plan must be unable to satisfy the minimum funding standard without substantial business hardship.
2. No waivers may be granted for more than 5 of any 15 consecutive plan years.
3. The interest rate for computing the amortization charge is determined under Code Section 6221(b).

[ERISA §303; I.R.C. §412(d)]

Note. The standard for determining whether a waiver can be granted for a single-employer plan is the employer's temporary substantial business hardship. For a multiemployer plan, the standard is substantial business hardship.

Q 10:30 What is a substantial business hardship?

Factors considered in determining *substantial business hardship* (whether temporary for a single-employer plan or otherwise for a multiemployer plan) include, but are not limited to, whether

1. The employer is operating at an economic loss;
2. There is substantial unemployment or underemployment in the trade or business or in the industry concerned;
3. The sales and profits of the industry concerned are depressed or declining; and

4. It is reasonable to expect that the plan will be continued only if the waiver is granted.

[ERISA §303(b); I.R.C. §412(d)(2)]

Q 10:31 Under what circumstances has the IRS determined that there is temporary substantial business hardship?

Yes. A plan sponsor that had been overwhelmed by the costs of replacing computer systems to avoid year 2000 (Y2K) problems was determined to be suffering a temporary substantial business hardship; the plan sponsor deferred all discretionary capital expenditures except for costs associated with Y2K compliance. [Priv. Ltr. Rul. 200001043]

Another plan sponsor was financially burdened by additional pension costs attributable to the additional funding requirements of Code Section 412(l), as amended by the Retirement Protection Act (RPA), and by an oversupply of competing products. The IRS determined that the company and its union workforce were committed to the long-term survival of the company and its pension plan. [Priv. Ltr. Rul. 200001044]

In Private Letter Ruling 200548034 (Dec. 2, 2005), a plan sponsor facing unanticipated funding obligations resulting from the plan's poor investment performance was also facing new competition and had acquired several new product lines that had been underperforming. However, in light of a number of measures the plan sponsor had implemented to correct its business hardship and recent favorable preliminary financial results, the IRS determined that the hardship appeared to be temporary.

In Private Letter Ruling 200512031 (Mar. 24, 2005), a plan sponsor that had historically been profitable began experiencing significant financial hardship in the early 2000s as a result of low prices for metal, weak demand for the company's products, a difficult economic environment due to import competition, and poor financial performance of some of the company's debt-financed investments outside the United States. The plan sponsor was able to achieve cost reductions through a variety of restructuring efforts in a Chapter 11 reorganization, and it emerged as a much more efficient operation, with financial projections showing a return to profitability and cash flows permitting the resumption of plan funding. In this case, the IRS determined that there was temporary business hardship.

Q 10:32 Are there circumstances under which an employer must make a contribution even if the employer has obtained an IRS waiver for that contribution?

Yes. In *International Union, United Automobile, Aerospace & Agricultural Implement Workers of America v. Keystone Consolidated Industries*[793 F.2d 810 (7th Cir. 1986)], the Seventh Circuit upheld the proposition, supported by the IRS as amicus curiae, that an employer obligated to make contributions under a collective bargaining agreement does not become relieved of that contractual obligation even though the IRS has granted the plan a minimum funding waiver for the year in question.

Q 10:33 Is an employer's controlled group considered for purposes of determining business hardship?

Yes. For plans other than multiemployer plans, if an employer is a member of a controlled group, it meets the temporary substantial business hardship requirements only if the employer and the controlled group of which the employer is a member (determined by treating all members of the group as a single employer) meet the business hardship test. [ERISA §303(d)(2); I.R.C. §412(d)(5)]

Q 10:34 What is a controlled group for purposes of obtaining a variance from the minimum funding requirements?

The term *controlled group* means any group treated as a single employer under Code Section 414(b), (c), (m), or (o). [ERISA §303(d)(2)(B); I.R.C. §412(d)(5)(B)]

Q 10:35 What are the time requirements for requesting a minimum funding variance from the Secretary of the Treasury?

Plans (other than multiemployer plans) must apply for a variance for a plan year no later than the 15th day of the third month beginning after the close of the plan year. [ERISA §303(d)(1); I.R.C. §412(d)(4)]

The sponsor of a plan (other than a multiemployer plan) must apply for a variance for a plan year no later than the 15th day of the third month beginning after the close of the plan year. [ERISA §303(d)(1); I.R.C. §412(d)(4)]

Q 10:36 Must participants be notified of a plan sponsor's request for a variance from the minimum funding standard requirements?

Yes. ERISA requires that before granting a minimum funding variance, the Secretary of the Treasury must require an applicant to furnish evidence that it has provided notice that it has filed an application for the waiver to each employer organization representing employees covered by the affected plan and each participant and beneficiary covered under the plan. [ERISA §303(e)(1); I.R.C. §412(f)(4)]

Q 10:37 May a plan sponsor request an extension of the period required to amortize any unfunded liability?

Yes. The Secretary of the Treasury may extend the period required to amortize any unfunded liability if he or she finds that an extension would carry out the purposes of ERISA and would provide adequate protection for participants under the plan and their beneficiaries and if the Secretary finds that the failure to allow an extension would

1. Result in (a) a substantial risk to the voluntary continuation of the plan or (b) a substantial curtailment of pension benefit levels or employee compensation; and
2. Be adverse to the interests of plan participants overall.

[ERISA §304(a); I.R.C. §412(e)]

Q 10:38 What is the interest rate used for any extension of the amortization period?

For a plan other than a multiemployer plan, the interest rate applicable for any plan year under any arrangement that the Secretary of the Treasury enters into in connection with an extension of the amortization period is the greater of (1) 150 percent of the federal midterm rate (as in effect under Code Section 1274 for the first month of such plan year) or (2) the rate of interest used under the plan in determining costs. For a multiemployer plan, the rate is determined under Code Section 6621(b). [ERISA §304(a); I.R.C. §412(e)(2)]

Q 10:39 May benefits be increased during the period of a funding waiver or extension of the amortization period?

No. No amendment of the plan that increases the liabilities of the plan because of any increase in benefits, any change in the accrual of benefits, or any change in the rate at which benefits become nonforfeitable under the plan may be adopted if a variance (see Q 10:28) or an extension of time (see Q 10:37) is in effect with respect to a plan or if a plan amendment described in ERISA Section 302(c)(8) has been made at any time in the preceding 12 months (24 months for a multiemployer plan). If a plan is amended in violation of such requirements, any such waiver or extension of time does not apply to any plan year ending on or after the date on which the amendment is adopted. [ERISA §304(b)(1); I.R.C. §412(f)(1)]

Q 10:40 Are there any exceptions to the prohibition against the adoption of a plan amendment while a variance or extension of time is in effect?

Yes. Amendments increasing benefits are permitted, provided

1. The Secretary of the Treasury determines that the amendments are reasonable and cause only *de minimis* increases in the liabilities of the plan;
2. The amendments only repeal an amendment described in ERISA Section 302(c)(8); or
3. The amendments are required as a condition of tax qualification under the Code.

[ERISA §304(b)(2); I.R.C. §412(f)(2)]

Q 10:41 Is security required for a waiver of the minimum funding standard or an extension of the amortization period?

Sometimes. The Secretary of the Treasury may require an employer maintaining a single-employer pension plan to provide security to the plan as a condition for granting or modifying a waiver of the minimum funding standards or an extension of the amortization period. [ERISA §306(a)(1); I.R.C. §412(f)(3)(A)(i)]

Any such security may be perfected and enforced only by the PBGC or, at the direction of the PBGC, by the contributing sponsor or a member of the sponsor's controlled group. [ERISA §306(a)(2); I.R.C. §412(f)(3)(A)(ii)]

Q 10:42 Are there circumstances under which security for waivers of the minimum funding standards cannot be required?

Yes. Security for waivers of the minimum funding standards cannot be required for any plan to the extent that the sum of the outstanding balance of (1) the accumulated funding deficiencies of the plan, (2) the amount of waived funding deficiencies of the plan, and (3) the amount of decreases in the minimum funding standard allowed because of the extension of the amortization period total less than $1 million. [ERISA §306(c); I.R.C. §412(f)(3)(C)]

Q 10:43 What is the penalty for violating the minimum funding standards?

Excise taxes may be assessed under Code Section 4971. In addition, a lien may arise (see Q 10:23) if the total of missed contributions (including interest) exceeds $1 million.

Q 10:44 Must security be posted if a plan is amended?

Yes, but only under certain circumstances. If a defined benefit plan (other than a multiemployer pension plan) adopts an amendment that results in an increase in the current liability for the plan year and the plan's assets equal less than 60 percent of the plan's current liability (including the current liability attributable to the plan amendment) for the plan year in which the amendment takes effect, the contributing sponsor (or any member of its controlled group) must post security with respect to such an amendment. [ERISA §307(a)]

Q 10:45 What is the amount of the security?

The security required to be posted must be in an amount equal to the excess of:

1. The lesser of—
   a. the amount of additional plan assets that would be necessary to increase the plan's funded current liability percentage to 60 percent (including the amount of the unfunded current liability under the plan attributable to the plan amendment), or
   b. the increase in the plan's current liability attributable to the plan amendment; over
2. $10 million.

[ERISA §307(c)]

Q 10:46 What is acceptable security?

Acceptable security is any of the following:

1. A bond issued by a corporate surety company that is an acceptable surety under Code Section 412;
2. Cash or U.S. obligations that mature in three years or less, held in escrow by a bank or similar financial institution; or
3. Other forms of security satisfactory to the Secretary of the Treasury and the parties involved.

[ERISA §307(b)]

Q 10:47 When is the security released?

The security is released (and amounts thereunder refunded with accrued interest) at the end of the first plan year that ends after the provision of security and for which the funded current liability percentage under the plan is not less than 60 percent. [ERISA §307(d)]

Q 10:48 What are the notice requirements regarding the adoption of amendments that require security?

A contributing sponsor required to provide security must notify the PBGC within 30 days after the amendment takes effect. [ERISA §307(e)]

Q 10:49 What is a frozen *pension plan*?

A *frozen pension plan* is a plan that has been amended to cease all future benefit accruals but from which all plan assets have not been distributed to participants or their beneficiaries. Participants in a frozen pension plan continue to be credited with vesting service in the benefits they have accrued through the date of the freeze, but they do not accrue additional pension benefits. The plan sponsor must also continue to satisfy the minimum funding standards with respect to the plan and continue to administer the plan (see Q 10:1). A significant effect of freezing a plan is that doing so effectively precludes new employees from participating in it. [Rev. Rul. 89-87, 1989-2 C.B. 81; Temp. Treas. Reg. §1.416-1T, Q&A 5]

> **Note.** A significant advantage of a frozen pension plan is that a plan sponsor can reduce costs because no future service will be included under the plan for benefit accruals. One disadvantage of a frozen plan is that it is still treated as an ongoing plan. Thus, for example, the plan sponsor must pay PBGC premiums, amend the plan to conform to any applicable new legislation or regulations, file annual reports, and distribute summary annual reports. In addition, plan participants must still be credited with service after the freezing date for vesting purposes.

> **Practice Pointer.** ERISA Section 204(h) and Code Section 4980F(e) require that notice of an amendment providing for a significant reduction in the rate of future benefit accrual must be provided within a "reasonable time" before the effective date of the amendment (see Q 11:46).

PBGC Reportable Events

Q 10:50 What is a reportable event?

A *reportable event*, generally speaking, is an event that may be indicative of a need to terminate the plan. There are two kinds of reportable events: (1) those for which reporting is required *after* the event has occurred (post-event notice); and (2) those for which reporting is required *in advance* of the event's effective date (advance notice).

Q 10:51 What are the post-event reporting requirements for reportable events?

Within 30 days after the plan administrator or contributing sponsor knows or has reason to know that a reportable event has occurred, he or she must notify the PBGC, and may use Form 10 for this purpose. The post-event reportable events are as follows:

A. Active participant reduction
B. Failure to make required minimum funding payments
C. Inability to pay benefits when due
D. Distribution to a substantial owner
E. Transfer of benefit liabilities
F. Change in contributing sponsor or controlled group
G. Liquidation of contributing sponsor or controlled group member
H. Extraordinary dividend or stock redemption
I. Application for minimum funding waiver
J. Loan default
K. Bankruptcy or similar settlement

Each of these events is described in detail in the PBGC's reportable events regulation. [29 C.F.R. pt. 4043, subparts A and B]

Q 10:52 Has the PBGC waived or extended the 30-day notice requirement for any of the post-event reportable events?

Yes. The PBGC has waived reporting of all reportable events with respect to all multiemployer plans and with respect to terminating single-employer plans once assets have been distributed or a trustee has been appointed for the plan under ERISA section 4042(c). [29 C.F.R. §4043.4(b)] In addition, the PBGC's regulation provides a variety of waivers and extensions that are tailored to the individual reportable events. [29 C.F.R. §4043.21-.35] In many cases, a waiver applies if the plan involved is well funded on the basis of actuarial assumptions used to determine the PBGC's variable-rate premium.

Q 10:53 What are the advance reporting requirements for reportable events?

Advance reporting requirements apply only to privately held companies where the plans maintained by the controlled group have (in the aggregate) more than $50 million in underfunding and a funding percentage for vested benefits of less than 90 percent, determined in both cases based on the assumptions used to calculate the PBGC's variable-rate premium. A contributing sponsor that is subject to the advance reporting requirements must notify the PBGC at least 30 days before the reportable event becomes effective, and may use Form 10-A for this purpose. The reportable events that are subject to advance reporting requirements are as follows:

A. Change in contributing sponsor or controlled group
B. Liquidation of contributing sponsor or controlled group member
C. Extraordinary dividend or stock redemption
D. Transfer of benefit liabilities
E. Application for minimum funding waiver
F. Loan default
G. Bankruptcy or similar settlement

Each of these events is described in detail in the PBGC's reportable events regulation. [29 C.F.R. pt. 4043, subparts A and C]

Q 10:54 Has the PBGC waived or extended the 30-day notice requirement for any of the advance notice reportable events?

Yes, but the waivers and extensions are much more limited than they are for post-event reportable events. These limited waivers and extensions are tailored to the individual reportable events. [29 C.F.R. §4043.62-.68]

Q 10:55 May the PBGC assess a penalty for failure to notify the PBGC of a reportable event in a timely manner?

Yes. Failure to provide the PBGC with certain notices or other material information, including reportable event notices, in a timely manner may result in a penalty of up to $1,100 per day. [ERISA §4071]

Q 10:56 Can the PBGC's failure to act in response to a notice of reportable event bar the PBGC from later asserting liability against the employer sponsoring the plan for which the notice was provided?

Apparently not. In *PBGC v. White Consolidated Industries, Inc*. [72 F. Supp. 2d 547 (W.D. Pa. 1999)], the court ruled that the PBGC's failure to act immediately in response to a reportable event notice of the change of sponsorship of pension plans and a statement by a PBGC lawyer that the PBGC did not intend to impose liability at that time did not provide a basis for estopping the PBGC from subsequently suing for employer liability.

Plan Termination

Q 10:57 May a defined benefit single-employer plan that is covered by Title IV only be terminated pursuant to the provisions of ERISA Title IV?

Yes. ERISA Title IV provides the exclusive means for terminating a covered single-employer defined benefit pension plan. [ERISA §4041(a)(1)]

Q 10:58 Does the termination of a defined benefit pension plan under ERISA Title IV subject the plan fiduciary to a claim of fiduciary breach?

Generally, no. The decision to terminate such a plan is normally considered a settlor function, not a fiduciary function.

Nevertheless, implementation of the decision to terminate may involve fiduciary activities, which must conform to ERISA Title I. Accordingly, the court in *Boucher v. Williams*[13 F. Supp. 2d 84 (D. Me. 1998)] ruled that the manner in which the terms of the plan termination are presented by a fiduciary to the plan participants can result in a claim of fiduciary breach. Relying on *Varity Corp. v. Howe*[516 U.S. 489 (1996)], the court held that "where failure to abide by ERISA's disclosure requirements involves misleading statements or intentional concealment, a fiduciary breach claim will arise."

A plan fiduciary does not violate its fiduciary duty as a result of taking action or withholding action required by the plan termination insurance provisions of ERISA Title IV. [ERISA §4023; see also ERISA §404(a)(1)(D).]

Q 10:59 What procedures does ERISA have for terminating pension plans?

Under ERISA, termination procedures generally may be initiated either by the plan administrator (a voluntary termination) or by the PBGC (an involuntary termination). The voluntary termination of a single-employer pension plan usually follows a different set of procedures depending on whether the pension plan is sufficiently funded in relation to its benefit liabilities. In addition to establishing the procedures for terminating defined benefit pension plans (whether single-employer, multiple-employer, or multiemployer), ERISA Title IV provides the PBGC with specific rights and duties concerning the administration of such plans.

Note. A multiple-employer plan is distinguished from a multiemployer plan in that the latter is maintained pursuant to one or more collective bargaining agreements with more than one employer, and the former is maintained by more than one employer (see Q 9:15) but not pursuant to any collective bargaining agreements. [ERISA §§3(37)(A), 4001(a)(3); I.R.C. §414(f)(1)]

Q 10:60 What are the types of voluntary plan terminations for a single-employer defined benefit pension plan?

Voluntary plan terminations of a single-employer defined benefit pension plan are of two types, both of which can be effected by a plan administrator: a standard termination [ERISA §4041(b)] and a distress termination. [ERISA §4041(c)] If a plan cannot meet the requirements for either of those types of terminations, it cannot be voluntarily terminated.

Q 10:61 What are the requirements for a standard termination of a single-employer pension plan?

A single-employer plan can terminate under a standard termination only if the plan has sufficient assets to satisfy all benefit liabilities, that is, to pay all the benefits to which employees and beneficiaries, both vested and nonvested, are entitled under the plan.

To make a plan sufficient, the plan sponsor can make a commitment to pay into the plan the shortfall, if any, on or before the date of distribution. [PBGC Reg. §4041.21(b)(1)] A sample form commitment to make a plan sufficient is included in the PBGC's standard termination forms and instructions package. In addition, a majority (50-percent-or-more) owner of the plan sponsor can agree "to forgo receipt of all or part of his or her benefit until the benefit liabilities of all other plan participants have been satisfied." [PBGC Reg. §4041.21(b)(2)]

A standard termination is possible only if the following further conditions are met:

1. Various notice and reporting requirements to plan participants, beneficiaries, any applicable employee associations, and the PBGC are satisfied; and
2. The PBGC does not issue a notice of noncompliance. If the PBGC issues a notice of noncompliance (and the notice of noncompliance is not changed on

reconsideration), the plan cannot terminate in a standard termination and the plan sponsor cannot terminate the plan voluntarily unless the requirements for a distress termination are met (see Q 10:66). [ERISA §4041(b)(1)]

Note. The excise tax has been eliminated on nondeductible contributions to terminating single-employer plans covered by PBGC with more than 100 participants to the extent that the contributions do not cause plan assets to exceed current liabilities. [I.R.C. §404(a)(1)(D)]

Q 10:62 Is the termination of an overfunded defined benefit pension plan a per se breach of fiduciary duty?

No. In *Bussian v. RJR Nabisco, Inc*. [223 F.3d 286 (5th Cir. 2000)], the court pointed out that under ERISA, neither the decision to terminate an overfunded plan nor a reversion of plan assets that is consistent with ERISA Section 4044(d) is a per se violation of any ERISA fiduciary duty. [*See*ERISA §508(b)(9) (exempting from prohibited transactions "[t]he making by a fiduciary of a distribution of the assets of the plan in accordance with the terms of the plan if such assets are distributed in the same manner as provided under ERISA Section [4044]. …"); Lockheed Corp. v. Spink, 517 U.S. 882, 890-91 (1996) (extending to pension benefit plans the notion that when employers terminate employee welfare plans, they do not act as fiduciaries and instead are analogous to settlors of a trust); Izzarelli v. Rexene Prods. Co., 24 F.3d 1506, 1524 (5th Cir. 1994).] Because an employer may, consistent with ERISA's provisions, receive a plan's surplus upon termination, the fact that the employer terminates a plan specifically to gain access to that surplus is not a violation. However, the court was quick to point out that under the appropriate fiduciary standard, an annuity's price cannot be the motivating factor until the fiduciary reasonably determines, through prudent investigation, that the providers under consideration are comparable in their ability to promote the interests of participants and beneficiaries. Without such a prior determination, consideration of an annuity's price, because it directly benefits the employer, can be taken as evidence that a fiduciary has placed an interest in a reversion above the interests of plan beneficiaries. This is contrary to the fiduciary's ERISA duties.

Q 10:63 In connection with a plan termination, must a fiduciary select an annuity provider whose portfolio is diversified?

The court ruled no in *Bussian v. RJR Nabisco, Inc*. [223 F.3d 286 (5th Cir. 2000)] The Fifth Circuit rejected that argument that ERISA Section 404(a)(1)(C) imposes on a fiduciary who is selecting an annuity provider the duty to select a provider whose portfolio is sufficiently diversified. The court focused on the language of ERISA Section 104(a)(1)(C), which deals specifically with "investments of the plan." The purchase of an annuity to facilitate plan termination is not an investment of the plan. It is, as ERISA Section 4041(b)(3) provides, a "final distribution of assets." Therefore, ERISA Section 404(a)(1)(C) does not impose upon a plan fiduciary the obligation to investigate or ensure the adequate diversification of an annuity provider's portfolio. The court pointed out that DOL Interpretive Bulletin 95-1 has a standard that focuses on the quality of the selected annuity. However, the court applied a standard that focused instead on the fiduciary's conduct. ERISA requires that fiduciaries keep the interests of beneficiaries foremost in their minds, taking all steps necessary to prevent conflicting interests from entering into the decision-making process. If a fiduciary undertakes this inquiry, the fiduciary satisfies its ERISA obligations if, based upon what it learns in its investigation, it selects an annuity provider it "reasonably concludes best to promote the interests of [the plan's] participants and beneficiaries." [Donovan v. Bierwirth, 680 F.2d 263, 271 (2d Cir.), *cert. denied*, 459 U.S. 1069 (1982)] The Fifth Circuit went on to hold that even if the fiduciary did not engage in the appropriate inquiry, ERISA obligations may nonetheless be satisfied if the provider selected would have been chosen had the fiduciary conducted a proper investigation. [See Roth v. Sawyer-Cleator Lumber Co., 16 F.3d 915, 919 (8th Cir. 1994) ("Even if a trustee failed to conduct an investigation before making a decision, he is insulated from liability if a hypothetical prudent fiduciary would have made the same decision anyway.").]

Q 10:64 Can a fiduciary be held liable for selecting a financially unstable insurance company to provide annuitized benefits to participants in connection with a plan termination?

Yes. In *Bussian v. RJR Nabisco, Inc*. [223 F.3d 286 (5th Cir. 2000)], the court ruled that an employer breached its ERISA fiduciary duties by selecting a financially unstable insurance company as the annuity provider in connection with the termination of the company's overfunded defined benefit pension plan. The insurance company invested in a high percentage of low-quality bonds; the insurer also submitted the lowest bid to provide annuities for benefits in connection with the plan termination. Although the court ruled that the employer was not required to select the safest annuity provider available (which position was espoused by the DOL in Interpretive Bulletin 95-1), the employer as a fiduciary was required (but failed) to identify an annuity provider that would best promote the interest of plan participants and beneficiaries.

Q 10:65 Can a plan fiduciary rely on an expert advisor in connection with the selection of an annuity provider for plan termination benefits?

Yes. In *Bussian v. RJR Nabisco, Inc*. [223 F.3d 286 (5th Cir. 2000)], the court held that an employer could generally rely on the advice of independent experts and credit ratings of insurance companies, but that "blind reliance" on such advice and ratings was inconsistent with fiduciary standards. [Howard v. Shay, 100 F.3d 1484, 1490 (9th Cir. 1996) ("Conflicted fiduciaries do not fulfill ERISA's investigative requirements by merely hiring an expert."), *cert. denied*, 520 U.S. 1237 (1997); Donovan v. Mazzola, 716 F.2d 1226, 1234 (9th Cir. 1983) ("[R]eliance on counsel's advice, without more, cannot be a complete defense to an imprudence charge."), *cert. denied*, 464 U.S. 1040 (1984); Donovan v. Bierwirth, 680 F.2d at 272 (2d Cir.), *cert. denied*, 459 U.S. 1069 (1982)] To rely on an expert's advice, a "fiduciary must (1) investigate the expert's qualifications, (2) provide the expert with complete and accurate information, and (3) make certain that reliance on the expert's advice is reasonably justified under the circumstances." A determination whether a fiduciary's reliance on an expert advisor is justified is informed by many factors, including the expert's reputation and experience, the extensiveness and thoroughness of the expert's investigation, whether the expert's opinion is supported by relevant material, and whether the expert's methods and assumptions are appropriate to the decision at hand. [*See, e.g*., Hightshue v. AIG Life Ins. Co., 135 F.3d 1144, 1148 (7th Cir. 1998); *cf. Howard*, 100 F.3d at 1490 ("To justifiably rely on an independent appraisal, a conflicted fiduciary need not become an expert in the valuation of closely held corporations. But the fiduciary is required to make an honest, objective effort to read the valuation, understand it, and question the methods and assumptions that do not make sense.").] The goal is not to duplicate the expert's analysis, but to review that analysis to determine the extent to which any emerging recommendation can be relied on.

Q 10:66 Can an underfunded single-employer plan be terminated voluntarily?

Yes, but only in a distress termination. A plan can be terminated in a distress termination only if each entity that is a contributing sponsor of the plan or member of a contributing sponsor's controlled group satisfies one of the following distress criteria (there is no requirement that all the entities satisfy the same criterion):

1. The entity is in a liquidation proceeding under bankruptcy law or similar state law;
2. The entity is in a reorganization proceeding under bankruptcy law or similar state law, and the court determines that the employer will be (a) unable to pay its debts pursuant to a plan of reorganization or (b) unable to continue in business outside a reorganization if the plan is not terminated, and the court approves the termination; or
3. The entity is unable to pay debts when due and unable to continue in business if the plan is not terminated; or

4. The costs of pension coverage have become unreasonably burdensome to the employer solely as a result of a decline in the workforce covered under all pension plans of the employer.

[ERISA §4041(c)(2)(B)]

Q 10:67 Can a plan termination be effected immediately?

No. A voluntary standard or distress termination begins with a 60-day advance notice of intent to terminate provided to affected parties (including, when a labor union is involved, that union and excluding, in the case of a standard termination, the PBGC). There are several other notices and filings that must be completed. Failure to follow these requirements can cause a termination not to become effective. [*See* Phillips v. Bebber, 914 F.2d 31 (4th Cir. 1990).]

Q 10:68 Can a party other than the plan administrator terminate a single-employer defined benefit pension plan?

Yes. The PBGC can initiate an involuntary termination of a pension plan in one of several ways. First, the PBGC must commence proceedings for an involuntary termination if it determines that a plan does not have assets available to pay benefits currently due under the terms of the plan. [ERISA §4042(a)]

The PBGC can also begin proceedings to terminate a plan when any of the following applies:

1. The plan has not met the minimum funding standards of the Code;
2. The plan will be unable to pay benefits when due;
3. The plan has made a distribution to an individual who is a "substantial owner" of the employer, which distribution is a reportable event (see Q 10:50); or
4. The PBGC's possible long-run loss with respect to the plan may reasonably be expected to increase unreasonably if the plan is not terminated.

[ERISA §4042(a)(1)–(4)]

Practice Pointer. Some courts have reviewed the PBGC determination as to whether failure to initiate an involuntary termination could reasonably be expected to increase the PBGC's long-run loss unreasonably by using the arbitrary and capricious standard under the Administrative Procedure Act. [*In re* Pan Am Airways Inc. Coop Retirement Income Plan, 777 F. Supp. 1179 (S.D.N.Y. 1991), *aff'd*, 970 F.2d 896 (2d Cir. 1992); PBGC v. Fel Corp., 798 F. Supp. 239 (D.N.J. 1992)]

Note. In the event the PBGC initiates an involuntary termination and the plan sponsor determines that it can terminate the plan through a standard or distress voluntary termination, the plan sponsor can initiate a voluntary termination. Such course of action can be beneficial to the participants and the plan sponsor.

Q 10:69 What is an employer's liability for unfunded benefit liabilities in a distress or involuntary termination with insufficient assets to satisfy all the plan's benefit liabilities?

Under Title IV of ERISA, each contributing sponsor of a terminated pension plan and each member of the sponsor's controlled group are jointly and severally liable as of the termination date to the PBGC for the total amount of unfunded benefit liabilities to all participants and beneficiaries under the plan in connection with the termination of a single-employer plan under a distress or involuntary termination. [ERISA §4062(a)] In the case of a single-employer plan maintained by multiple controlled groups, special rules are used to allocate the liability among the different controlled groups. [ERISA §4064(b)]

Q 10:70 Does a lien arise for the collection of employer liability?

Yes. If any person liable to the PBGC upon a plan termination neglects or refuses, after demand, to pay the amount by which a plan's benefit liabilities exceed the current value of the plan's assets, a lien arises in an amount not to exceed the unpaid liability in favor of the PBGC on all property and rights to property, whether real or personal, belonging to that person. [ERISA §4068(a)]

Q 10:71 Is there a limit on the amount of the PBGC lien?

Yes. To the extent that the plan's benefit liabilities exceed the plan's assets, the PBGC's prejudgment lien for termination liability is capped at 30 percent of the collective net worth of the contributing sponsor and all members of its controlled group. [ERISA §4068(a)]

The collective net worth of the liable persons is the sum of the individual net worth of each contributing sponsor and each member of the sponsor's controlled group that has a net worth greater than zero (increased by the amount of any assets improperly transferred). The net worth of a person is determined on the basis that best reflects, in the determination of the PBGC, the current status of the person's operations and prospects at the time chosen by the PBGC (during the 120-day period ending on the termination date). [ERISA §4062(d)(1); PBGC Reg. §§4062.4, 4062.5]

Q 10:72 What is the priority of the lien?

ERISA Title IV adopts the lien priority rules of Code Section 6323. Generally, those rules provide that the lien will not affect the rights of a purchaser, holder of a security interest, mechanic's lien, or judgment lien creditor if any such person's title is acquired or his or her security interest is perfected before notice of the PBGC lien is filed. [ERISA §4068(c)(1)] Typically, that would mean that perfected security interests would be unaffected by a later-arising PBGC lien.

Q 10:73 Is a PBGC claim for employer liability under ERISA Section 4062 entitled to administrative priority under the Bankruptcy Code?

The PBGC takes the position that the employer liability claim is entitled to administrative priority under the Bankruptcy Code if an underfunded plan terminates after the employer files for bankruptcy. Administrative priority under the Bankruptcy Code is accorded to "actual, necessary costs and expenses of preserving the estate." [11 U.S.C. §§503(b)(1)(A), 507(a)(1)] The PBGC's position has been consistently rejected by the courts. In ruling on the matter, various courts have underscored the propositions that (1) priorities in bankruptcy are narrowly construed and (2) the Bankruptcy Code—not ERISA—determines the priority. [*See, e.g.*, *In re* Bayly Corp. (PBGC v. Skeen), 163 F.3d 1205 (10th Cir. 1998).] Those courts have held that a PBGC claim made under ERISA Section 4062 is to be treated as a general unsecured claim against the plan sponsor, without any priority.

Q 10:74 Is a PBGC claim for employer liability under ERISA Section 4062 entitled to the priority afforded taxes due and owing under the Bankruptcy Code?

No. The PBGC has argued that its claims are entitled to be treated as taxes due and owing entitled to provide priority treatment under Sections 503(b)(1)(B) and 507(a)(1) or under Section 507(a)(8) of the Bankruptcy Code. [11 U.S.C. §§503(b)(1)(B), 507(a)(1), and 507(a)(8)] The courts, however, have rejected the PBGC's claims for plan asset insufficiency as priority taxes. [*See, e.g.*, *In re* CSC Indus., Inc., 232 F.3d 505 (6th Cir. 2000).]

Q 10:75 Does ERISA preempt the Bankruptcy Code?

No. ERISA Section 514(d) provides that, with very limited exceptions, "[n]othing in this subchapter shall be construed to alter, amend, modify, invalidate, impair or supersede any law of the United States." The intersection of the Bankruptcy Code and PBGC claims under ERISA has been summarized as follows: "After consideration of all the arguments, we conclude PBGC is not entitled to special rights in bankruptcy and its ERISA powers and rights do not give it priority over the other unsecured creditors." [*In re* CF&I Fabricators of Utah, Inc., 150 F.3d 1293 (10th Cir. 1998)] Similarly, in the case of *In re CSC Industries, Inc*. [232 F.3d 505 (6th Cir. 2000)], the court held that a claim for missed minimum funding contributions is not entitled to "tax" status. In *dicta*, the court in the *CSC Industries* case stated that no tax status arises where a lien has not been imposed under Code Section 412(n)(4), due to the operation of the automatic stay [ERISA Section 362(a)(4)], triggered by a Chapter 11 filing. The *dicta* is contrary to the holding in the case of *In re CF&I Fabricators*.

Plan Termination

Q 10:76 Is a claim by the IRS for excise taxes under Code Section 4971(a) for missed contributions entitled to a tax priority under the Bankruptcy Code?

No. Under the Bankruptcy Code, excise taxes are entitled to priority payment. [11 U.S.C. §507(a)(8)(E)] The U.S. Supreme Court, however, has ruled that the Section 4971(a) tax is a penalty and not an "excise tax" within the meaning of the Bankruptcy Code. [United States v. Reorganized CF&I Fabricators of Utah, 518 U.S. 213 (1996)] Adhering to precedent, the Supreme Court found that the label on the amount owing was not determinative. Rather, the issue was whether the amount was a "pecuniary burden laid upon individuals or property for the purpose of supporting the Government" or for the purpose "of defraying the expenses of government or of undertakings authorized by it." The Court examined whether the Code Section 4971 payment functions as a tax or a penalty; it concluded that the payment was "obviously" a penalty.

Under the Bankruptcy Code, taxes are generally entitled to priority payment. [11 U.S.C. § 507(a)(8)(E)] The U.S. Supreme Court, however, has ruled that the Section 4971(a) tax is a penalty and not an "excise tax" within the meaning of the Bankruptcy Code. [United States v. Reorganized CF&I Fabricators of Utah, 518 U.S. 213 (1996)] Adhering to precedent, the Supreme Court found that the label on the amount owing was not determinative. Rather, the issue was whether the amount was a "pecuniary burden laid upon individuals or property for the purpose of supporting the Government" or for the purpose "of defraying the expenses of government or of undertakings authorized by it." The Court examined whether the Code Section 4971 payment functions as a tax or a penalty; it concluded that the payment was "obviously" a penalty.

In IRS Chief Counsel Notice CC-2006-007 (Dec. 22, 2005), the IRS announced that it will argue in appropriate cases that the pension underfunding penalties in Section 4971 that relate to post-petition pension obligations are entitled to administrative expense priority under Section 503(b)(1)(A) of the Bankruptcy Code.

Q 10:77 Is a PBGC claim for missed contributions that give rise to a lien under a Code Section 412(n) entitled to tax priority in a bankruptcy proceeding?

The PBGC has argued that missed contributions above $1 million are entitled to tax priority under the Bankruptcy Code because Code Section 412(n)(4)(C) provides that any amount with respect to which a lien is imposed under Section 412(n) is treated as a tax due and owing to the United States. However, liens cannot arise after an employer files for bankruptcy because of the automatic stay. [11 U.S.C. §362] As a result, courts that have considered the question have rejected PBGC's claim. For ERISA or Code provisions to be read into Bankruptcy Code provisions, there has to be an "explicit connector between" such provisions and the Bankruptcy Code. [*In re* CF&I Fabricators of Utah, Inc., 150 F.3d 1293 (10th Cir. 1998)] Because the Bankruptcy Code provision giving priority to excise taxes does not expressly reference Code Section 412(n) or ERISA, there is no explicit connector, but rather only a "tangential connection" between the statutes.

The Tenth Circuit looked behind the "tax" label under ERISA and the Code to determine whether the amounts claimed by the PBGC were "functionally" a tax in *In re CF&I Fabricators of Utah, Inc*. [150 F.3d 1293 (10th Cir. 1998)] The appellate court in *CF&I Fabricators* asked four questions to determine whether missed contributions that give rise to a lien under Code Section 412(n) are entitled to tax priority under the Bankruptcy Code:

1. Are the contributions an involuntary pecuniary burden, regardless of name, laid upon the individuals or property?
2. Are the contributions imposed by or under authority of the legislature?
3. Are the contributions imposed for public purposes, including the purpose of defraying expenses of government or undertakings authorized by it?

4. Are the contributions imposed under the police or taxing power of the state?

The court found that its four-part analysis disposed of the PBGC's argument for tax priority. It determined that the object of the contributions is not to defray the expenses of the government or any governmental undertaking but, rather, to finance a private obligation—benefits under private pension plans. Although the contributions are required by statute, the court found that there is "simply no credible argument that the required payments fund either a function of the United States or any of its undertakings." Accordingly, the court ruled that the PBGC's claim for unpaid minimum contributions was not to be accorded tax priority.

Q 10:78 Is any part of a PBGC claim for unpaid contributions entitled to an administrative priority under the Bankruptcy Code?

Yes. With respect to a minimum funding claim asserted by the PBGC, the portion of the claim attributable to "normal costs" for benefits actually earned by employees during the debtor company's post-petition operations (and that portion below) has been held to be entitled to administrative priority under Bankruptcy Code Sections 503 and 507. However, the courts have rejected the PBGC's claims that any contribution required by ERISA and the Code due after the bankruptcy filing is entitled to priority. [See, e.g., *In re* CF&I Fabricators of Utah, Inc., 150 F.3d 1293 (10th Cir. 1998); PBGC v. Sunarhauserman, Inc., 126 F.3d 811 (6th Cir. 1997).]

Q 10:79 How is the amount of the claim entitled to administrative priority calculated?

In *In re Sunarhauserman, Inc*. [126 F.3d 811 (6th Cir. 1997)], the Sixth Circuit ruled that the claim of the PBGC for minimum funding contributions for the post-petition period is entitled to an administrative priority only for the normal cost component of the contribution, only to the extent that it relates to benefits earned by covered employees during the post-petition period, and only to the extent of an additional downward adjustment based on actual employment levels. In short, the court required the PBGC to match the claimed contributions with the actual services rendered. The court stressed that administrative priority can be accorded only to a liability that arises post-petition (the nonnormal cost component of the contribution was for a pre-petition liability). "[R]egardless of the substantive law on which the claim is based, the proper standard for determining that claim's administrative priority looks to when the acts giving rise to a liability took place, not when they accrued." [126 F.3d 811, 818]

Q 10:80 Is there any priority for contributions owed to an employee benefit plan for the period before the date the employer files a petition for relief under the Bankruptcy Code?

Yes. The Bankruptcy Code provides interrelated priorities for pre-petition wages and contributions. [11 U.S.C. §507(a)(4), (5)] Each employee is entitled to a $10,000 priority in bankruptcy cases filed on or after April 20, 2005, for wages, salaries, or commissions (including vacation, sick leave, and severance pay) earned by the employee during the 180 days before the earlier of the date of the filing of the petition or the date of the cessation of the debtor's business. [11 U.S.C.§507(a)(4)] There is also a priority claim for contributions to employee benefit plans [11 U.S.C. § 507(a)(5)], arising from services rendered within 180 days of the earlier of the filing of the petition or the cessation of the business, but only to the extent of the number of employees covered by the plan multiplied by $10,000, minus the aggregate amount paid to these employees under the wage priority.

Q 10:81 Is a claim for unpaid workers' compensation insurance premiums owed by a bankrupt estate entitled to priority under Bankruptcy Code Section 507(a)(4)?

The term *employee benefit plan* is used in Bankruptcy Code Section 507(a)(4), but that term is not defined in the Bankruptcy Code. Three circuit courts have held that unpaid workers' compensation insurance premiums are not entitled to priority. [*In re* Birmingham-Nashville Exp., Inc., 224 F.3d 511 (6th Cir. 2000); *In re* HLM Corp., 62 F.3d 224 (8th Cir.

1995); and *In re* Southern Star Foods, Inc., 144 F.3d 712 (10th Cir.), *cert. denied*, 525 U.S. 978 (1998)] The Ninth Circuit has reasoned otherwise in *Employers Insurance of Wausau v. Plaid Pantries, Inc*. [10 F.3d 605 (9th Cir. 1993)].

Q 10:82 Can a plan be forced to return contributions to a plan sponsor that has filed for relief under the Bankruptcy Code?

Perhaps. What the plan can be forced to do may depend on (1) whether the contributions were made in accordance with the plan's terms, ERISA, and the Internal Revenue Code or (2) whether the contributions were objectionable under other federal law. For example, the Sixth Circuit has held that where contributions to a partnership's profit sharing plan were not made in accordance with the terms of the plan document, certain plan contributions could be garnished by the bankruptcy trustee and were not protected by ERISA's anti-alienation provisions; the court concluded that the contributions should not have been considered plan assets because they were never properly contributed to the plan. [*In re* Bell & Beckwith, 5 F.3d 150 (6th Cir. 1993)] In addition, in *Greenfeld v. Goldschein* (*In re Goldschein*) [241 B.R. 370 (Bankr. D. Md. 1999)], the court held that ERISA's anti-alienation rules do not prevent the avoidance of fraudulent transfers by a debtor to a defined benefit pension plan. The court determined that under the circumstances of the case, the transfers were made with the actual intent to hinder or delay creditors within one year prior to the petition date.

On the other hand, a bankruptcy court in Nebraska ruled that a Chapter 7 debtor's voluntary contributions to an ERISA-qualified plan were not transfers for or on account of an antecedent debt and therefore were not preferences. The court also ruled that the debtor received reasonably equivalent value for the contributions, so they could not be avoided as constructively fraudulent transfers. [*In re* Loomer (Butler v. Loomer), 222 B.R. 618 (Bankr. D. Neb. 1998)]

Q 10:83 Are PBGC claims for premiums under ERISA Section 4006 entitled to any priority under the Bankruptcy Code?

Perhaps. In *In re Finley, Kumble, Wagner, Heine, Underberg, Manley, Myerson & Casey*[160 B.R. 882 (Bankr. S.D.N.Y. 1993)], the court ruled that premiums owed to the PBGC for work actually performed during the administration of an estate may be entitled to an administrative priority. The court held that the claim for premiums was to be prorated, just as the court in *In re Sunarhauserman, Inc*. [126 F.3d 811 (6th Cir. 1997)] (see Q 10:79) prorated the claims for contributions entitled to administrative expense priority.

Q 10:84 Is a PBGC claim for plan asset insufficiency to be valued using assumptions chosen by the PBGC when the plan sponsor has filed for relief under the Bankruptcy Code?

The courts are split on whether PBGC assumptions or "prudent investor" assumptions should be used. To ensure a degree of equality of payment between claims that mature in the future and claims that can be paid on the date of bankruptcy, the Bankruptcy Code requires that claims for future payment must be reduced to present value. [11 U.S.C. §502(b)] Relying on ERISA Title IV, the PBGC argues that ERISA requires that the claim for plan asset insufficiency [29 U.S.C. §§1362, 1368] has to be valued using assumptions chosen by the PBGC. [ERISA §§4001(a)(18), 4062(b)(1)(A)]

In connection with the PBGC's selection of a discount factor, the Bankruptcy Court in *In re CF&I Fabricators of Utah, Inc*. [19 Employee Benefits Cas. (BNA) 2371 (Bankr. D. Utah Nov. 27, 1995)] held that—to the extent that the PBGC valuation process is an effort to replicate the price of an annuity to close out a terminating plan—that discount factor does not reflect the future earning power of money. Instead of the PBGC's 6.5 percent, the Bankruptcy Court selected a 12.3 percent discount rate, based on evidence presented of a prudent hypothetical investment portfolio. The district court also ruled against the PBGC on its appeal of the decision of the Bankruptcy Court to apply the "prudent investor rate" to value the PBGC's claim for plan asset insufficiency under ERISA Section 4068. Because the rate urged by the PBGC did not reflect the future earnings of invested money, the district court

concluded that the PBGC could inflate its claim by valuing it with a low interest rate and then invest the amount it collected at a much higher market rate. [214 B.R. 16 (D. Utah 1997)] The court of appeals [150 F.3d 1293, 1300–01 (10th Cir. 1998)] affirmed and pointed to the ERISA definition of the *amount of unfunded benefit liabilities*, which was the underpinning of the PBGC's argument, and stressed that the definition was expressly applicable only "for purposes of" ERISA Title IV. Therefore, the court ruled that the ERISA definition "cannot extend to bankruptcy." The court of appeals also found that the ERISA provisions relied on by the PBGC conflict with provisions of the Bankruptcy Code [*see, e.g*., 11 U.S.C. §1123(a)(4)] and that that conflict must be controlled by the Bankruptcy Code. The U.S. Court of Appeals for the Sixth Circuit reached the same conclusions in the case of *In re CSC Industries, Inc*. [PBGC v. Belfance, 232 F.3d 505 (6th Cir. 2000)]

However, in the US Airways bankruptcy, the bankruptcy concluded that the PBGC assumptions should be applied. The court concluded that the claim should be determined based on applicable nonbankruptcy law (i.e., ERISA). [*In re* US Airways Group, Inc., 303 B.R. 784 (Bankr. E.D. Va. Dec. 29, 2003)]

Q 10:85 Are PBGC claims for plan asset insufficiency ever considered to be duplicative of PBGC claims for unpaid contributions?

Yes. In *In re Simetco, Inc*. [No. 93-61772, 1996 Bankr. LEXIS 1399 (Bankr. N.D. Ohio Feb. 15, 1996)], the court disallowed the PBGC's claim for unfunded benefit liabilities, finding it duplicative to the extent of the face value of the PBGC's claim for minimum funding contributions. The PBGC unsuccessfully contended that the two nonpriority, unsecured claims were separate and distinct and should be allowed, with the unfunded benefit liability claim reduced only by the collectible value of the minimum funding contribution claim—not the face amount. The PBGC appealed this decision of the bankruptcy court in *PBGC v. Cohen & Co., Distribution Trustee*[No. 5:96CV608 (N.D. Ohio July 23, 1996)] The district court found that the bankruptcy court's ruling was not clearly erroneous and affirmed its decision to allow the PBGC's claims for minimum funding contributions and unfunded benefit liabilities, but to reduce the unfunded benefit liability claim by the full face value of the minimum funding contribution claim, rather than the collectible value of that claim as the PBGC had requested. [*SeeIn re* Chateaugay Corp., 115 B.R. 760 (Bankr. S.D.N.Y. 1990) (holding that to allow in full both claims would result in the PBGC's recovering two dollars of claims for one dollar of loss on its minimum funding contribution claim); *In re* Finley, Kumble, Wagner, Heine, Underberg, Manley, Myerson, & Casey, 160 B.R. 882 (Bankr. S.D.N.Y. 1993) (same).]

Q 10:86 Are there limitations on improving benefits while a plan sponsor is in bankruptcy?

Yes. An employer that is a debtor in a bankruptcy proceeding can increase benefits in a PBGC-covered, single-employer plan only if (1) the plan would have a funded current liability percentage after the benefit increase of 100 percent or more and (2) the benefit increase does not become effective until after the effective date of the employer's plan of reorganization.

The prohibition on benefit increases does not affect benefit increases negotiated or adopted during the bankruptcy that become effective after the employer emerges from bankruptcy, or preclude benefit increases from becoming effective during bankruptcy under plan amendments adopted or collective bargaining agreements entered into before bankruptcy. It also does not apply to plan amendments that (1) the Secretary of the Treasury determines are reasonable and provide for only *de minimis* increases in the liabilities of the plan with respect to employees of the debtor, (2) repeal an amendment described in ERISA Section 302(c)(8) or Code Section 412(c)(8), or (3) are needed to satisfy qualification requirements under the Code. [ERISA §§204(i), 4022(f)]

If a benefit increase is adopted during bankruptcy, phase-in of the PBGC's guarantee begins from the later of the effective date stated in the plan amendment that increases benefits or the effective date of the plan of reorganization. [ERISA §4022]

In addition, with certain express exceptions, the adoption of a prohibited amendment during a plan sponsor's bankruptcy proceeding violates the Code's qualification requirement. This provision is effective for plan amendments adopted on or after December 8, 1994. [I.R.C. §401(a)(33)]

Q 10:87 May retirees sue their employer's estate under a common-law estoppel theory for the difference between the value of their promised pension benefits and their PBGC guaranteed benefits under a plan trusteed by the PBGC?

Such a claim has been held to be preempted under ERISA. [*In re* Lineal Group, Inc., 226 B.R. 608 (Bankr. M.D. Tenn. 1998); *see alsoIn re* Adams Hard Facing Co., 129 B.R. 662 (W.D. Okla. 1991)]

Q 10:88 May employees sue under ERISA federal common law or under Section 301 of the Labor Management Relations Act to recover nonguaranteed benefits from a plan sponsor that has been forced to terminate its plan because it could no longer afford to maintain it?

Such claims are held to be preempted under ERISA. [United Steelworkers v. United Eng'g, Inc., 52 F.3d 1386 (6th Cir. 1995)] The court reached its conclusion from an analysis of the purposes underlying the major overhaul of ERISA Title IV and the termination insurance program under the Single-Employer Pension Plan Amendments Act and the Pension Protection Act. Before that statutory overhaul, two federal courts expressly held that the limitation of employer liability to the PBGC under ERISA Section 4062 did not limit the employer's direct contractual liability to its employees. [*In re* M&M Transp. Co., 3 B.R. 722 (S.D.N.Y. 1980); *In re* Alan Wood Steel Co., 5 B.R. 620 (Bankr. E.D. Pa. 1978)]

Q 10:89 Can pension plan participants sue their employer for pension plan benefits, even after bankruptcy court approval of the employer's plan or reorganization?

Yes. In the case of *In re Kendavis Holding Co*. [249 F.3d 383 (5th Cir. 2001), *reh'g and reh'g en banc denied*, 275 F.3d 48 (5th Cir. 2001)], creditors brought an involuntary bankruptcy proceeding against the plan sponsor under chapter 11. The plan sponsor excluded the pension plan participants from its bankruptcy schedules and chose not to inform the participants of the Chapter 11 proceedings. In negotiating its plan for reorganization, the plan sponsor agreed to take $20 million out of surplus assets in the plan for the benefit of its creditors. The plan sponsor sent participants notices stating its intention to terminate the pension plan and representing that the participants' benefits would not be affected.

One of the participants filed a claim for pension benefits, but he did not timely file the claim. The court of appeals ruled that the participant's claim was not discharged due to the participant's failure to timely file the claim, where the participant was not yet eligible to receive benefits and where the plan sponsor had not notified the participants about the bankruptcy proceeding. Although the participant may have had actual knowledge of the bankruptcy proceeding after reading a newspaper article, a person in the participant's position with such knowledge should not be expected to file a claim in bankruptcy court to protect his pension rights. Cutting off the participant's right to seek his benefits would violate the participant's constitutional due process rights.

Q 10:90 Does a debtor who acts as an ERISA plan fiduciary qualify as a fiduciary under the Bankruptcy Code provision that provides that a debt for fraud or defalcation while acting in a fiduciary capacity is nondischargeable in bankruptcy?

Yes. In the case of *In re Hemmeter*[242 F.3d 1186 (9th Cir. 2001)], the court ruled that a debtor who acts as an ERISA plan fiduciary qualifies as a fiduciary under Bankruptcy Code Section 523(a)(4). Therefore, the ERISA plan losses allegedly caused by the debtor could be nondischargeable debts in bankruptcy, because Bankruptcy Code Section 523(a)(4) provides

that a debtor may not be discharged from a debt "for fraud or defalcation" while acting in "fiduciary capacity." In reaching this holding, the court recognized that ERISA satisfies the traditional requirements for a statutory fiduciary because ERISA defines a fiduciary's duties and imposes obligations on a fiduciary before the alleged wrongdoings. However, based on the facts in the case, the court ruled that the debtor could discharge the debts relating to pension plan losses. In this case, the plan participants alleged that the debtor breached his ERISA fiduciary duties as a result of a decline in the plan's stock value.

Q 10:91 Does a breach of ERISA's fiduciary duties automatically make damages for such a breach nondischargeable in bankruptcy?

No. A determination that the debtor was an ERISA fiduciary and that fiduciary duties were breached does not mean that the debtor engaged in a defalcation. [*In re* Hemmeter, 242 F.3d 1186 (9th Cir. 2001)] The debtor was specifically authorized to invest in the stock, so the alleged breach of duties did not establish a viable claim for defalcation under Bankruptcy Code Section 523(a)(4). The definition of *defalcation* includes both the "misappropriation of trust funds or money held in any fiduciary capacity; [and the] failure to properly account for such funds." Thus, the essence of defalcation in the context of Bankruptcy Code Section 523(a)(4) is a failure to produce funds entrusted to a fiduciary. The participants did not allege any accounting failure or misappropriation. Rather, the participants alleged only damages resulting from a decline in the value of stock, in which plan assets were expressly permitted to be invested. The alleged breaches of ERISA fiduciary duties do not amount to a "defalcation while acting in a fiduciary capacity" within the meaning of Bankruptcy Code Section 523(a)(4).

Q 10:92 When is termination liability for a multiple-employer plan assessed?

Liability under a multiple-employer plan with unfunded benefit liabilities is assessed when the plan terminates [ERISA §4064] or upon a substantial employer's withdrawal from the plan [ERISA §4063]. Terminations of multiemployer plans [ERISA §4041A] and withdrawals of employers from multiemployer plans [ERISA §4201 et seq] are subject to different rules. (See chapter 9.)

Q 10:93 Who is liable when a multiple-employer plan terminates?

Liability is imposed on all contributing sponsors of a plan that has two or more contributing sponsors at least two of whom are not under common control at the time the plan is terminated or who, at any time within the five plan years preceding the date of termination, made contributions to the plan. [ERISA §4064(a)]

Q 10:94 How is termination liability established for a multiple-employer plan?

The liability to the PBGC for unfunded benefit liabilities for each contributing employer is determined using a method similar to that used for determining the liability of an employer under a single-employer plan; however, the liability is allocated to each contributing employer as follows:

$$\text{Total Liability} \times \frac{\text{Amount required to be contributed to the plan by contributing sponsor for five plan years ending prior to termination date}}{\text{Total amount required to be contributed to the plan by all contributing sponsors for such five-year period}}$$

[ERISA §4064(b)]

Q 10:95 What is a substantial employer?

A *substantial employer* is an employer whose required contributions to a single-employer plan are at least 10 percent of the required contributions to the plan for at least two consecutive plan years out of the three previous plan years. [ERISA §4001(a)(2)]

Q 10:96 What is the liability of a substantial employer that withdraws from a multiple-employer plan?

The liability of a substantial employer on its withdrawal from a multiple-employer plan is determined using one of three methods. The first method is similar to the method used for determining the liability of an employer under a single-employer plan. The liability is computed as if the plan had been terminated by the PBGC on the date of withdrawal of the substantial employer. This amount is multiplied by the following fraction:

$$\frac{\text{Total amount required to be contributed to the plan by the withdrawing contributing sponsor for the five plan years ending before the withdrawal}}{\text{Total amount required to be contributed to the plan by all contributing sponsors for such five-year period}}$$

[ERISA §4063(b)]

Any liability payments collected by the PBGC are held in escrow. (In lieu of an escrow, the employer may be required to furnish a bond in an amount not exceeding 150 percent of the liability determined.) If the plan terminates within the five-year period commencing on the date of the withdrawal, the escrowed amount (or the amount realized on the bond) will be added to the plan's assets, with any amount in excess of what is required to meet the PBGC's obligations refunded to the withdrawn substantial employer. [ERISA §4063(c)(3)]

The second option is available only if the plan administrator shows that the withdrawal of one or more contributing sponsors has resulted or will result in a significant reduction in total contributions to the plan. With this alternative, the PBGC may require the plan assets to be equitably allocated between participants no longer working in covered service under the plan as a result of the withdrawal and participants who remain in covered service under the plan. The portion of the plan assets allocated to the participants no longer in covered service would be treated as a termination initiated by the PBGC. The remaining portion of the plan assets (those allocated to participants still in covered service under the plan) would be treated as a separate ongoing plan. [ERISA §4063(d)]

The third method for satisfying a substantial employer's liability is for the employers contributing to the plan to enter (or to have entered) into an indemnification agreement, acceptable to the PBGC, that satisfies the purposes of the withdrawal and termination liability rules for multiple-employer plans under ERISA Title IV. [ERISA §4063(e)]

Q 10:97 Can an employer incur liability as a result of a substantial reduction in the number of participants in a single-employer plan?

Yes. If an employer ceases operations at a facility in any location and, as a result, more than 20 percent of its employees who are participants in a plan established by the employer are separated from employment, the employer is treated as if it were a substantial employer in a multiple-employer plan, subject to ERISA Sections 4063, 4064, and 4065. [ERISA §4062(e)] As a result of such a cessation, the employer may be required to escrow an amount equal to the plan's underfunding on a termination basis multiplied by the percentage reduction in active participants as a result of the cessation of operations. [71 Fed. Reg. 34,819 (June 16, 2006) (to be codified at 29 C.F.R. § 4062.8(a))] Alternatively, the employer may post a bond up to 150 percent of that amount. If the plan does not terminate within five years after the cessation of operations at the facility, the escrow is returned without interest or the bond is canceled. [ERISA §4063(c)]

Such an event may also constitute a partial termination requiring vesting to the extent funded.

Q 10:98 Does the PBGC have the power to restore a terminated plan?

Yes. If the PBGC determines that a plan being terminated under ERISA Section 4041 or 4042 should not be terminated because of circumstances the PBGC determines to be relevant,

it is authorized to cease any activities undertaken to terminate the plan and to take whatever action is necessary and within its power to restore the plan to its prior status. If the plan has already been terminated, the PBGC may take action to restore the plan to its pretermination status, including, but not limited to, the transfer to the employer or plan administrator of control of part or all of the remaining assets and liabilities of the plan. [ERISA §4047; PBGC v. LTV Corp., 496 U.S. 633 (1990)]

Special Issues for Underfunded Plans

Q 10:99 Are there additional financial costs for plan sponsors of underfunded single-employer plans?

Yes. The premium that must be paid for a single-employer plan that is covered by the PBGC's plan termination insurance program consists of a flat-rate amount for each participant plus a variable-rate amount that is based on the level of plan funding. The per-participant flat-rate premium was increased from $19 for the 2005 plan year to $30 for the 2006 plan year and is indexed to wage growth for future plan years. The variable-rate premium for the plan equals $9 for each $1,000 of the plan's unfunded vested benefits (UVBs). For example, the PBGC premium for a plan with 1,000 participants and $5 million in UVBs would be $75,000 (based on a flat-rate premium of $30,000 and a variable-rate premium of $45,000) for the 2006 plan year. There are special rules on how to calculate a plan's UVBs, including specified actuarial assumptions. In addition, there is a per-participant premium exit fee of $1,250 per year, for three years, for an employer who terminates a plan after 2005 and before 2012 in a distress or involuntary termination but continues in business (e.g., through a bankruptcy reorganization). [ERISA §§4006 and 4007; 29 C.F.R. pts. 4006 and 4007]

Q 10:100 Are plan sponsors of underfunded plans subject to additional reporting and disclosure requirements?

Yes. Controlled groups maintaining plans with signficant funding problems are required to file annual reports with the PBGC providing identifying, actuarial, and financial information. The PBGC uses this information to monitor plans that may represent significant exposure for the termination insurance program. The requirement to file these annual reports applies if:

1. The aggregate unfunded vested benefits of all underfunded plans maintained by the contributing sponsor and the controlled group exceed $50 million;
2. The conditions for imposing a lien for missed plan contributions exceeding $1 million have been met; or
3. Any portion of minimum funding waivers exceeding $1 million for any plan maintained by the contributing sponsor and controlled group members remains unpaid.

Any information submitted to the PBGC is exempt from the public disclosure requirements of the Freedom of Information Act, and no such material may be made public except (1) in the context of a relevant administrative or judicial proceeding or (2) to either body of Congress, including any authorized committee or subcommittee of Congress.

[ERISA §4010]

Q 10:101 Do plan administrators of underfunded pension plans have to satisfy special disclosure requirements to participants?

Yes. The plan administrator of a plan that is required to pay the variable-rate PBGC premium and that does not qualify for an exemption based on the "deficit reduction contribution" funding rules must issue a notice to plan participants and beneficiaries and to any union reporting on the plan's funded status and the limits on the PBGC's benefit guarantee if the plan were to terminate while it is underfunded. The annual notice must be written in a manner calculated to be understood by the average plan participant. PBGC regulations specify the time, manner, and form of issuance of the notice. [ERISA §4011; 29 C.F.R. pt. 4011] The PBGC annually issues a Technical Update that includes a model participant notice. [*See, e.g.*, PBGC Technical Update 2005-1.]

Q 10:102 Is there any penalty for failing to provide the notice to participants required by ERISA Section 4011?

Yes. If a plan administrator fails to provide a participant notice under ERISA Section 4011 in a timely manner, or omits material information from the notice, the PBGC may, under ERISA Section 4071, assess a penalty of up to $1,100 for each day that the failure continues. [29 C.F.R. §4011.3(c)]

Fraudulent Transactions and Successor Liability

Q 10:103 What steps can the PBGC take in response to an employer's attempts to evade liability under ERISA?

If a principal purpose of any person entering into any transaction is to evade liability under ERISA Title IV and the transaction becomes effective within five years before the termination date of an underfunded pension plan on which such liability would be based, the person and the members of the controlled group are subject to liability under ERISA Title IV as if the person was a contributing sponsor of the terminating plan as of the termination date. [ERISA §4069(a)]

Example 1. Parent Co. sells the assets of a division in a 100 percent leveraged buyout. Parent Co. lends Purchaser a majority of the purchase price in exchange for notes from Purchaser secured by the division's assets. Purchaser assumes the division's underfunded pension plan. When the division files for bankruptcy three years later, Parent Co. could have predecessor liability for pension underfunding. [*In re* International Harvester's Disposition of Wis. Steel, 681 F. Supp. 512 (N.D. Ill. 1988); see also PBGC v. White Consol. Indus. Inc., 998 F.2d 1132 (3d Cir. 1993).]

Example 2. A subsidiary acquired its parent company's profitable assets and left the parent with liabilities, including underfunded pension plans. A court ruled that the parent's restructuring was designed to defraud creditors. Subsequently, the PBGC obtained a declaratory judgment that the estate of the bankruptcy debtor-subsidiary was liable as a matter of law for its parent company's contributions to its parent's underfunded plans. The court ruled that a transfer that is deemed fraudulent to one creditor is deemed fraudulent to all creditors, present and future. The court went on to hold that there was no reason to treat the parent's plan's participants differently from any other of the parent company's creditors, because the fraudulent transfer law is designed to prevent debtors from defrauding creditors by giving those creditors a means of undoing the detrimental effects of a fraudulent transfer. [*In re* Raytech Corp., 241 B.R. 790, 23 Employee Benefits Cas. (BNA) 2994 (Bankr. D. Conn. Dec. 6, 1999)]

In addition, ERISA Section 4212(c) provides that with respect to multiemployer plans, if a principal purpose of any transaction is to evade or avoid withdrawal liability, the assessment of liability is applied and liability is determined and collected without regard to such a transaction.

Example 3. Pension Fund assessed withdrawal liability on Reitco. The owner of Reitco then transferred real estate holdings to his wife, who was unaware of the assessment of withdrawal liability. The court held that real estate conveyances to a spouse by an individual who withdrew as a contributing employer to a multiemployer pension plan are void, since the transferee spouse's knowledge is irrelevant to imposition of withdrawal liability, and since in this case the totality of the circumstances supported the plan's contention that the conveyances, which were made shortly after employer accepted a service of summons and complaint in the plan's collection action, were intended to evade or avoid withdrawal liability and therefore could be disregarded under ERISA Section 4212(c). [Connors v. Vick, 15 Employee Benefits Cas. (BNA) 1342 (S.D. W. Va. Mar. 13, 1992)]

Q 10:104 What is the effect of a corporate reorganization on liability under a pension plan?

Under ERISA Title IV, the following corporate events cause the new entity to be treated as the successor plan sponsor:

1. An entity ceases to exist by reason of a reorganization that involves a mere change in identity, form, or place of organization, however effected: a successor corporation resulting from such reorganization is treated as the person to whom ERISA Title IV applies.
2. An entity ceases to exist by reason of liquidation into a parent corporation: the parent corporation is treated as the person to whom ERISA Title IV applies.
3. An entity ceases to exist by reason of a merger, consolidation, or division: the successor corporation or corporations are treated as the person to whom ERISA Title IV applies.

[ERISA §4069(b)]