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PENSION & BENEFITS

REPORTER

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Stealth Liability Lurks for Employers with Ongoing Pension Plans Who Downsize or Sell Businesses

BY HAROLD J. ASHNER

It happens all too often. An employer with a PBGC-covered pension plan decides to downsize, perhaps by closing a plant as part of a restructuring effort designed to increase the employer's profitability and long-term viability. There is no intention on the part of the employer to terminate the pension plan, and no grounds exist for PBGC to terminate it involuntarily. Rather, the plan will remain ongoing in continued full compliance with the minimum funding rules. Shortly after the downsizing, the employer notifies PBGC of the resulting active participant reduction by filing a routine reportable event notice. No thought has been given to any potential PBGC liability, since PBGC liability focuses on plan termination and this plan is not terminating.

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PBGC, after reviewing the reportable event filing, contacts the employer to inform it that the downsizing may be a "Section 4062(e) event." If so, the employer will have triggered a liability to PBGC equal to a portion—or in some cases *all*—of the pension plan's underfunding determined on a conservative PBGC plan termination basis to provide protection in case the plan terminates without adequate funding in the next five years. The employer and its advisers had engaged in what they thought was careful planning and had anticipated all of the costs associated with the downsizing, except for one. Unfortunately, the one they missed may end up dwarfing the ones they spotted.

Section 4062(e) of the Employee Retirement Income Security Act has been "on the books" since the original 1974 version of ERISA, but was very rarely enforced by PBGC for more than 30 years, in part because the statutory liability formula created significant enforcement challenges. However, in mid-2006, PBGC completed a rulemaking that created a regulatory liability formula to replace the statutory formula.[1] This regulatory "fix" set

[1] The 2006 final rule, published at 71 Fed. Reg. 34819 (June 16, 2006), is available at http://edocket.access.gpo.gov/2006/pdf/E6-9503.pdf (See 116 PBD, 6/16/06; 33 BPR 1461, 6/20/06). For a summary and analysis of this final rule, *see* "PBGC's Final Rule on Liability for Facility Shutdowns Affects Downsizing Employers" by Harold J. Ashner, *Pension & Benefits Re-*

the stage for PBGC to pursue Section 4062(e) liability aggressively, and it has been doing so ever since. As PBGC noted in a more recent and still pending rulemaking[2]—one that has the potential to greatly expand the reach of ERISA Section 4062(e) and that is a major focus of this article—since the time of the 2006 rulemaking, there has been significant activity in the enforcement of this previously dormant provision :

> Over the next three and-a-half years [since the time of the 2006 rulemaking establishing a regulatory liability formula], PBGC resolved 37 cases under section 4062(e) through negotiated settlements valued at nearly $600 million, providing protection to over 65,000 participants.[3]

The more recent and still pending rulemaking is a proposed rule that would provide significant guidance on ERISA Section 4062(e) and that would also (as noted above) greatly expand its reach. Among other things, it would sweep in ''going-concern'' asset sales and, at least arguably, stock sales as events that could trigger Section 4062(e) liability.

The Basics: Liability

Any discussion of ERISA Section 4062(e) liability necessarily starts with the statutory language, which consists of just one sentence that raises far more questions than it resolves:

> If an employer ceases operations at a facility in any location and, as a result of such cessation of operations, more than 20 percent of the total number of his employees who are participants under a plan established and maintained by him are separated from employment, the employer shall be treated with respect to that plan as if he were a substantial employer under a plan under which more than one employer makes contributions and the provisions of sections 4063, 4064, and 4065 shall apply.[4]

The cross-reference to the rules governing the withdrawal of a substantial employer from a multiple-employer plan led to a liability formula that PBGC considered to be ''impracticable''[5] and, for that reason, was the impetus for the 2006 rulemaking substituting a different liability formula. With the regulatory liability formula in place, the basics of Section 4062(e) liability are as follows:

Liability Trigger. As stated in the statute, Section 4062(e) liability is triggered when ''an employer ceases operations at a facility in any location and, as a result of such cessation of operations, more than 20 percent of the total number of [its] employees who are participants under a plan established and maintained by [it] are separated from employment.''

The logic behind this liability trigger is unclear, and the legislative history offers little in the way of illumination. Certainly there can be certain downsizing events that portend employer financial distress and therefore provide a rationale for requiring some protection for PBGC. But why tie it to there being a ''cessation'' of ''operations'' at a particular ''facility in any location'' or to the active participant reduction experienced by one pension plan as a result of that cessation? Whether the liability is triggered under these criteria is often a matter of happenstance largely unrelated to the significance of the event. Consider, for example, the following:

- What if the liability is triggered where the separated employees, who represent more than 20 percent of the active participants in one pension plan, also represent (*e.g.*) only 1 percent of the employer's overall workforce?
- Indeed, what if the employer's overall workforce is increasing, not decreasing, at the time of the event as the employer redirects resources to more profitable endeavors?
- What if a covered cessation clearly signals nothing more than a move to even greater profitability as a money-losing operation is discontinued?
- On the other hand, if the goal is to capture downsizing events that signal future financial problems, why is there no liability where the employer's overall workforce drops precipitously (*e.g.*, by 75 percent) based on reductions or cessations spread across many different facilities and affecting primarily employees who are not participants in any of the employer's pension plans?

Liability Amount. Under PBGC's 2006 regulatory liability formula, the amount of the liability is the total amount of the plan's underfunding multiplied by the percentage reduction in active participants.[6] For this purpose, underfunding equals the plan's unfunded benefit liabilities determined as if the plan had terminated immediately after the date of the cessation of operations, using PBGC assumptions (which often lead to ''sticker shock'' for an unprepared employer).

For example, assume that a plan is underfunded by $100 million on an ongoing funding basis but by $200 million on a PBGC termination basis and experiences a 25 percent reduction in active participants in connection with a Section 4062(e) event. The resulting liability amount under PBGC's regulatory formula is $50 million (*i.e.*, 25 percent of $200 million).

It is not clear why the regulatory liability formula is tied to the active participant reduction percentage resulting from the cessation, given in particular that: (1) the financial support for the pension plan is not limited to the portion of the employer's business that conducted the operations that ceased; and (2) the underfunding in the plan is likely to be attributable primarily not to active participants, but rather to inactive participants (particularly those in pay status).

Consider an employer with thousands of employees and several pension plans, one of which is an underfunded legacy plan with several hundred participants, only 10 of whom are still active. If the employer shuts down a facility and separates all 10 active participants, the liability under the PBGC formula will be 100 percent of the plan's underfunding, even though the separated active participants may represent less than 1 percent of the employer's overall workforce and of the plan's benefit liabilities and unfunded benefit liabilities.

Whatever the regulatory liability amount assessed by PBGC is, there will be cases in which there is little or no need for PBGC to pursue it because there is little or no reason to believe that the plan will terminate in a dis-

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porter (BNA) at pp. 1546–49 (June 27, 2006) (121 PBD, 6/23/06; 33 BPR 1546, 6/27/06).

[2] (152 PBD, 8/10/10; 37 BPR 1809, 8/17/10); 75 Fed. Reg. 48283 (Aug. 10, 2010).

[3] *Id*. at 48283.

[4] ERISA Section 4062(e), 29 U.S.C. § 1362(e).

[5] 71 Fed. Reg. 34819 (June 16, 2006)

[6] 29 CFR § 4062.8(a).

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BPR ISSN 1069-5117

tress or involuntary (PBGC-initiated) termination within the next five years. At the other extreme, there will be cases where pursuing the liability could be counterproductive in that it could itself be the cause of employer failure and, with it, the very distress or involuntary plan termination that the liability is designed to provide protection for.

PBGC, as an existing (involuntary) creditor for (*e.g.*) $200 million is not better off securing (*e.g.*) $50 million of the $200 million than it would be if the employer survived and funded the plan fully over time. The challenge is to persuade PBGC, in an appropriate case, that pursuit of the liability would be unnecessary or counterproductive.

Methods of Satisfying Liability. Under the statute, PBGC can demand that the employer provide it with an escrow in the amount of the Section 4062(e) liability (*e.g.*, $50 million in the previous example) or purchase a bond for up to 150 percent of that amount (*e.g.*, $75 million) to protect the pension plan in the event it terminates in a distress or involuntary termination within the next five years. If such a termination occurs, the escrowed funds or the bond proceeds are added to plan assets (subject to certain limits); otherwise, at the end of the five-year period, the escrowed funds are returned (but without any interest) or the bond is cancelled.[7]

Clearly, these statutory methods of satisfying the liability are often not very satisfying for the employer or for PBGC.

- *Employer.* For the employer, making a five-year interest free loan to PBGC in the form of an escrow payment might be viewed as a less than ideal investment opportunity, and the cost of obtaining a bond, assuming one can be obtained, may be prohibitive.

- *PBGC.* For PBGC, having protection that disappears entirely at the end of the five-year period will in many cases be a negative, particularly where the Section 4062(e) matter is not resolved until well into the five-year period.

Fortunately, in practice, the statutory escrow or bond methods of satisfying the liability are rarely used. Instead, PBGC works with the employer to fashion a settlement that typically calls for additional contributions to the plan or some form of security other than an escrow payment or purchase of a bond, as detailed later in this article. In several press releases announcing settlements of Section 4062(e) liability, PBGC has stated its goal of achieving ''settlements that safeguard pension plans, while recognizing the business needs of the companies that sponsor them.''[8]

The Basics: Reporting

When a Section 4062(e) event occurs, there are typically two independent reporting requirements that need to be considered:

- *Section 4063(a) Notice.* Under Section 4063(a), there is a requirement that the plan administrator notify PBGC of the Section 4062(e) event within a 60-day period and request that PBGC determine the resulting liability.[9]

- *Reportable Event Notice.* Under ERISA Section 4043 and PBGC's implementing regulations, there is a requirement that the plan administrator or contributing sponsor notify PBGC of an active participant reduction reportable event (which is usually triggered in connection with a Section 4062(e) event) within a 30-day period.[10]

Either the Section 4063(a) notice or the reportable event notice may be due first, and filing either one does not obviate the need to file the other. The reasons for the headcount reduction are relevant for purposes of the Section 4063(a) notice (as only those separations that ''result'' from the cessation are taken into account), but are not relevant (except for certain waiver and extension purposes, as noted below) for purposes of the reportable event notice.

Section 4063(a) Notice. The 60-day period that sets the deadline for the plan administrator to file the Section 4063(a) notice starts to run, according to *proposed* guidance from PBGC in its pending rulemaking,[11] on the later of the cessation date and the date the 20 percent headcount reduction threshold is crossed.

Any waivers or extensions that may apply to the active participant reduction reportable event notice do not apply to the Section 4063(a) notice; thus, to take an extreme example, the separation from employment of one of four active participants in a ten-life overfunded plan will trigger this reporting requirement if the separation was the result of a covered cessation. Until the pending rulemaking is completed, and assuming no contrary intervening guidance from PBGC, the Section 4063(a) notice may be combined with an active participant reduction reportable event notice,[12] but caution should be exercised to ensure that the combined notice meets the timeliness and other requirements applicable to each notice.

As discussed later in this article, PBGC has proposed as part of its pending rulemaking to provide relief in connection with this reporting requirement by allowing the plan administrator to disregard, for certain reporting purposes, separations from employment of employees who worked at a facility other than the one that experienced the cessation (*e.g.*, where some warehouse workers are separated because of a decreased workload resulting from the cessation of operations at one of the factories the warehouse was servicing).[13] Because this relief is not yet in effect, however, an effort should be made to take into account all covered separations.

Reportable Event Notice. An active participant reduction reportable event occurs ''when the number of active participants under a plan is reduced to less than 80 percent of the number of active participants at the beginning of the plan year, or to less than 75 percent of

[7] ERISA Section 4063(b), (c), 29 U.S.C. § 1363(b), (c).

[8] *See*, *e.g.*, PBGC Press Release 10-50 (Sept. 3, 2010), available at http://www.pbgc.gov/media/news-archive/news-releases/2010/pr10-50.html.

[9] ERISA Section 4063(a), 29 U.S.C. § 1363(a).

[10] ERISA Section 4043(a), (c), 29 U.S.C. § 1343(a), (c); 29 CFR Part 4043, Subparts A and B.

[11] 75 Fed. Reg. at 48288, 48293.

[12] 75 Fed. Reg. 48283, 48288 at n. 7 (Aug. 10, 2010); *see also* Q&A 20 of PBGC's 2007 Enrolled Actuaries Meeting Blue Book, available at http://www.pbgc.gov/docs/2007bluebook.pdf.

[13] 75 Fed. Reg. at 48288, 48293.

the number of active participants at the beginning of the previous plan year.''[14]

Based on informal guidance from PBGC, this means that there can be up to two separate active participant reduction reportable events in any one plan year, and that such an event may occur at the beginning of a new plan year if the count is less than 75 percent of what it was at the beginning of the previous plan year, even though the count has most recently gone up (perhaps significantly), not down.[15]

The plan administrator and the contributing sponsor of the plan are required to file the reportable event notice within 30 days after knowing, or having reason to know, that the event has occurred, unless a waiver or extension applies;[16] however, a filing by either of them will be deemed to be a filing by the other.[17]

A variety of reporting waivers and extensions are available for an active participant reduction reportable event notice,[18] including a small plan waiver (where the plan had fewer than 100 *total* participants at the beginning of the current or previous plan year) and a number of waivers and extensions that are tied to the plan's funding status on a basis relating to variable-rate premium calculations.

Some of these waivers or extensions are conditioned (at least in part) on the active participant reduction *not* being tied to cessations of operations, so as to reduce the likelihood that a waiver or extension would apply in circumstances where there may be a Section 4062(e) liability to pursue. Under transitional guidance that is in effect for reportable events occurring during the 2010 plan year,[19] it is permissible to reach back to the funded status as of the first day of the 2009 plan year for certain waiver purposes and to the first day of the 2008 plan year for certain extension purposes.

Late last year, PBGC proposed a major overhaul of its reportable events regulation under which all of the existing automatic waivers and extensions that apply to an active participant reduction reportable event would be eliminated.[20] In their place would be just one waiver (and no extensions): a waiver where another active participant reduction was reported in accordance with PBGC regulations within the past year.[21]

However, PBGC at the same time proposed to help avoid duplicative reporting by excluding from consideration—in determining whether an active participant reduction reportable event has occurred—any active participant reductions to the extent that they (1) fall within the provisions of Section 4062(e) (for cessations of operations) or 4063(a) (for withdrawals of substantial employers from multiple-employer plans) and (2) are timely reported to PBGC as required under ERISA Section 4063(a).[22] In many cases, this exclusion from consideration would, in effect, constitute another reportable event waiver.

Of course, it is still just a proposal, and the need to file both a Section 4063(a) notice and a reportable event notice in those cases where the exclusion would have eliminated the duplicative reporting will therefore continue.

Unresolved Interpretive Issues

Section 4062(e) raises a host of unresolved interpretive issues, including issues bearing on whether a covered event has occurred, what the resulting liability is, or both. Until the recently-issued proposed rule, PBGC has provided little in the way of published guidance on these issues, leaving their resolution largely to case-by-case determinations and negotiations.

There is also little in the way of case law guidance on these issues, as the Section 4062(e) liability was largely unenforceable before PBGC's 2006 regulatory ''fix,'' with no litigation (just settlements) since then. Although PBGC's pending proposed rule would provide guidance on many of these issues, this guidance is not in effect, could change at the final rule stage, and may be subject to challenge even once embodied in a final rule.

These unresolved interpretive issues, which will be discussed in greater detail, along with others, in the next section of this article in the context of the pending proposal, involve such matters as:

- Whether and, if so, under what circumstances Section 4062(e) liability can be triggered based on a ''going concern'' asset sale or even a stock sale;
- What constitutes a ''facility'' or a ''facility in any location'';
- Whether cessation of only one ''operation'' of two or more being conducted at a given facility can trigger the liability and, if so, what constitutes a discrete ''operation'';
- Whether and when a ''cessation'' is treated as occurring;
- Whether and when an employee is treated as having been ''separated from employment'';
- The circumstances in which a separation is treated as having been the ''result'' of the cessation; and
- How and as of when to determine the active participant base to be used for purposes of the 20 percent threshold test and for purposes of the liability fraction.

The existence of so many unresolved interpretive issues can have a significant bearing on negotiations to resolve a potential liability under Section 4062(e). Particularly since the remedies available to PBGC have a five-year ''shelf life'' (in that any escrow would be refunded or bond cancelled if the plan remains ongoing at the end of the five-year period), extended litigation over these issues will often not make sense for PBGC and thus may provide an added incentive for PBGC to agree to a prompt settlement on terms the employer can live with. On the other hand, there will be ''open and shut'' cases presenting no such issues, leaving PBGC with significant leverage to insist on favorable terms in a settlement.

[14] 29 CFR § 4043.23(a).

[15] *See* Q&A 12 of PBGC's 2006 Enrolled Actuaries Meeting Blue Book, available at http://pbgc.gov/docs/2006bluebook.pdf.

[16] 29 CFR § 4043.20.

[17] 29 CFR § 4043.3(a)(3).

[18] 29 CFR § 4043.23(c), (d).

[19] Technical Update 09-4 (''Reportable Events; Funding-Related Determinations; Missed Quarterly Contributions; Guidance for 2010 Plan Years''), available at http://pbgc.gov/practitioners/law-regulations-informal-guidance/content/tu16998.html.

[20] (223 PBD, 11/23/09; 36 BPR 2674, 11/24/09); 74 Fed. Reg. 61248 (Nov. 23, 2009).

[21] *Id.* at 61251, 61256.

[22] *Id.*

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Proposed Rule Highlights

The proposed rule provides significant guidance relating to Section 4062(e), addressing many, but by no means all, of the interpretive issues raised. In addition, the proposal sets forth rules that would apply in connection with the enforcement of Section 4062(e), such as reporting and recordkeeping requirements. The proposed changes would go into effect for Section 4062(e) events with cessation dates on or after the effective date of a final rule.[23] This section of the article will cover some of the highlights of the proposal.

Applicability to 'Going Concern' Asset Sales. Perhaps the most controversial aspect of the proposal is that it would treat a ''going concern'' asset sale, where operations and employment are discontinued by the seller, but seamlessly continue without interruption, in a ''same desk'' situation, with the buyer, as triggering Section 4062(e) liability.

PBGC issued several opinion letters in the late 1970s and early 1980s concluding that there was no Section 4062(e) event in the context of various ''going concern'' asset sales then presented to it for consideration. More recently, however, PBGC officials have suggested that such asset sales may constitute Section 4062(e) events, at least where the pension liabilities associated with the transferred employees remain with the seller.

The proposed rule stakes out the aggressive position that a ''going concern'' asset sale can be a covered Section 4062(e) event, interpreting expansively both a ''cessation'' (by disregarding the continuation of the operation at issue by the buyer) and a ''separation'' (by similarly disregarding the employee's continuation of employment with the buyer).[24]

The preamble does not discuss the PBGC Opinion Letters that ruled there was no Section 4062(e) event in a number of ''going concern'' asset sale situations, other than to note that the proposed regulation ''would displace and supersede all of PBGC's prior opinion letter pronouncements addressing section 4062(e).''[25]

The rationale for sweeping in, along with downsizing events, going-concern asset sales, is not clear. These are ordinarily arms-length transactions trading one set of assets (an ongoing business operation) for another (cash, notes, etc.), with no particular reason to believe that the transaction is a sign of any impending financial problems. Indeed, there are many employers whose business consists in significant part of buying and selling businesses.

Whether Congress intended Section 4062(e) to have such a broad reach is an issue that may have to be resolved, ultimately, by the courts. However, if PBGC's interpretation is incorporated into a final rule and withstands any court challenges, one can expect PBGC to have a great deal more involvement in corporate transactions in the future, with the pricing and even the feasibility of the transactions affected by the potential for Section 4062(e) liability.

Applicability to Stock Sales. A potentially even more controversial aspect of the proposal—if it indeed *is* an aspect of the proposal—is the treatment of stock sales as triggering Section 4062(e) liability. Assume that controlled group ABC, consisting or Parent A and Subsidiaries B and C, sells the stock of Subsidiary C to controlled group DEF, consisting of Parent D and Subsidiaries E and F, and that both the operations and employment that might arguably trigger Section 4062(e) liability continue with Subsidiary C without any change. Does the mere fact that Subsidiary C becomes part of a new and different controlled group matter for Section 4062(e) purposes? Reading PBGC's proposal literally, it arguably does matter.

The preamble repeatedly refers to the ''employer,'' including when PBGC makes the point that it disregards whether operations continue with ''another employer'' or employment continues with ''the new employer.''[26] And the proposed regulatory text also refers to the ''employer'' in making these and similar points.[27]

Significantly, the proposed regulatory text defines ''employer'' (through a series of cross-references) in a manner that treats all members of a controlled group together as being but a single employer.[28] With that definition, is controlled group CDEF to be treated as ''another employer'' and as the ''new employer'' for purposes of the proposed rule, on the theory that pre-sale controlled group ABC and post-sale controlled group CDEF constitute different ''employers''? If so, stock sales may be covered for purposes of the proposed rule in the same way as asset sales: operations and employment are discontinued by employer ABC, but continue with employer CDEF.

Under the literal language of the proposed rule, the stock sale could thus constitute a Section 4062(e) event even though operations and employment remain at all times with Subsidiary C. PBGC made no explicit mention of this possibility, but noted asset sales as just ''[o]ne example'' of a situation where an ''operation is continued or resumed by another employer at the same or another facility.''[29] Hopefully, the final rule will make clear that stock sales were not intended to be covered by the proposal.

'Operations.' In some cases, two or more discrete operations are conducted at a ''facility in any location.'' If one or more, but fewer than all, of those operations cease, could that constitute a Section 4062(e) event? If so, how does one determine what constitutes a sufficiently distinct ''operation'' to treat it independently for Section 4062(e) purposes?

PBGC's proposal[30] is to shift from the plural ''operations'' used in the statute to the singular ''operation'' used in the proposed regulation. As a result, ceasing just one of two or more operations could trigger Section 4062(e) liability, even though the facility remains open with significant ongoing (other) operations staying in place. If this aspect of the proposal becomes part of the final rule and withstands any court challenges, there will be many situations in which PBGC could assert Section 4062(e) liability where the circumstances are a far cry from a facility closing.

[23] 75 Fed. Reg. at 48289.
[24] 75 Fed. Reg. at 48285–86, 48291, 48292.
[25] *Id*. at 48289.
[26] *Id*. at 48285–86.
[27] *Id*. at 48291 (prop. § 4062.26(c)(1)(ii)), 48292 (prop. §§ 4062.27, .28(f)).
[28] *Id*. at 48291 (prop. § 4062.22).
[29] *Id*. at 48285.
[30] *Id*. at 48285, 48291.

Under the proposal, an ''operation'' is defined as ''a set of activities that constitutes an organizationally, operationally, or functionally distinct unit of an employer,'' with weight being given to how a particular set (or similar sets) of activities is ''considered or treated in the relevant industry, in the employer's organizational structure or accounts, in relevant collective bargaining agreements, by the employer's employees or customers, or by the public.'' Thus, if PBGC's proposed guidance goes into effect, the determination of what constitutes an ''operation'' for Section 4062(e) purposes would be heavily dependent on a variety of facts and circumstances.

'Facility' or 'Facility in any Location.' It is not always clear what constitutes a ''facility'' or a ''facility in any location.'' Can two or more buildings that are in close proximity together constitute a single ''facility in any location''? How about two or more buildings that are across town or across the country but that together perform a single ''operation''? Can a single building house two or more separate ''facilities'' for Section 4062(e) purposes?

Under the proposal,[31] PBGC would define the ''facility (or facility in any location)'' that is ''associated with an operation'' as ''the place or places where the operation is performed,'' and would provide that a facility ''is typically a building or buildings''; that a facility ''may be or include any one or more enclosed or open areas or structures''; and that the same facility ''may be associated with more than one operation.''

What is not clear, particularly given the ''place *or places*'' (emphasis added) language in the proposed regulatory text, is the extent to which a single ''facility in any location'' might be viewed as encompassing ''places'' in different and geographically distant ''locations,'' notwithstanding the statutory limitation to a (singular) facility in ''a'' (singular) location. In any event, the proposed definition of ''facility (or facility in any location),'' if incorporated into the final rule, will require a great deal of case-specific evaluation of a wide variety of facts and circumstances.

'Cessation.' It is not always clear whether or when a ''cessation'' occurs. How complete does it need to be? What if a small percentage of the ''operations'' (or, under PBGC's proposal, of ''an operation'') continue(s) indefinitely? How permanent must the ''cessation'' be?

PBGC's proposal[32] is to have different rules for determining what constitutes a ''cessation'' and when it occurs, depending on whether the cessation is voluntary or involuntary.

- *Voluntary cessations.* A voluntary cessation would occur when ''the employer discontinues all significant activity in furtherance of the purpose of the operation.'' According to the preamble, ''continued processing of materials on hand would typically constitute significant activity in furtherance of the purpose of the operation,'' whereas ''desultory sales of left-over inventory would typically not.'' Similarly, maintenance and security activities, while ''important to a manufacturing operation,'' nonetheless ''do not further the purpose of the operation'' and, thus, cessation of a manufacturing operation could occur ''even though there was a continuance of maintenance and guard services.''

- *Involuntary cessations.* For an involuntary cessation, the cessation date would not necessarily occur when all significant activity stopped. Instead, the employer would have some time to react to the events causing the discontinuance of the operation before it ripens into a cessation for Section 4062(e) purposes.
  - In the case of a discontinuance caused by ''employee action such as a strike or sickout,'' the employer would have until one week after the employee action ended to decide whether to resume operations, whereas in the case of a cessation caused by ''a sudden and unanticipated event (other than an employee action) such as a natural disaster,'' the employer would have 30 days after discontinuing the operation to make the decision.
  - During the allotted time, if the employer resumes the operation, there is no Section 4062(e) cessation, and if the employer decides not to resume it, the Section 4062(e) cessation occurs when that decision is made (or, if earlier in the case of a discontinuance caused by employee action, on the date the employee action ended).
  - Upon expiration of the allotted time, absent employer resumption of the operation or an earlier decision not to resume it, the discontinuance would ripen into a cessation for Section 4062(e) purposes as of the date the employee action ended (in the case of a discontinuance caused by employee action) or the 30th day after the discontinuance (in the case of a discontinuance caused by a sudden and unanticipated event).

Certainly, there may be circumstances in which more time is needed for an employer to react than what was offered in the proposal, and hopefully the final rule will build in more time or at least some flexibility in appropriate circumstances.

Under the proposal, PBGC would determine whether a discontinuance of an operation is a cessation for Section 4062(e) purposes without regard to whether the operation is continued or resumed at another facility or (as discussed earlier in this article in connection with asset and stock sales) by another employer, or whether, when the operation is discontinued, a different operation is undertaken.

It is at best unclear why the liability should arise where the ''operation'' at issue is simply being moved to another location rather than ''ceasing,'' or where the employer is simply substituting one operation for another. In neither case is there any particular reason to believe that employer financial distress is on the horizon.

PBGC stated in the preamble that ''any hope or expectation the employer may have that the discontinued work will be resumed would be irrelevant to whether the discontinuance is a cessation.''[33] The reach of this principle is unclear. Does it mean that an employer who decides to retool a factory over a period of (*e.g.*) 45 days could trigger Section 4062(e) liability (given that, as discussed next, a temporary layoff for more than 30 days counts as a separation), even though the employer has

[31] *Id.*
[32] *Id.* at 48285–86, 48291.
[33] *Id.* at 48286.

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ISSN 1069-5117

at all times had in place and fully implements a plan to continue, not cease, the operation? Or would such a situation be viewed as not involving any ''discontinuance'' and, thus, the issue of whether ''the discontinuance'' is ''a cessation'' would not even be reached? Hopefully the final rule will make clear that there is a distinction between suspending and ceasing an operation.

'Separation.' There can also be issues surrounding whether and when a particular employee is considered to have been ''separated from employment.'' What if the employee is laid off for a short or even a long period with some possibility or even a firm expectation of recall? What if the employee is reinstated after having been separated? How, if at all, do replacement hires count?

The proposal[34] would provide that an employee ''separates'' from employment ''when the employee discontinues the active performance, pursuant to the employee's employment relationship with the employer, of activities in furtherance of any of the employer's operations,'' subject to three exceptions:

- *Short-term layoff exception:* No separation would occur if it is reasonably certain the employee will resume active work for the employer within 30 days, unless resumption has not occurred during the 30-day period (in which case separation will be considered to have occurred when the employee discontinued the active work).

- *Reinstatement exception:* A pre-cessation-date separation would not count if, as of the cessation date, the employee has been rehired and is both an employee of the employer and a participant in the affected plan.

- *Replacement exception:* Similarly, a pre-cessation-date separation would not count if, as of the cessation date, the employee has been replaced and the replacement employee is both an employee of the employer and a participant in the affected plan.

The proposal also treats as irrelevant (as discussed earlier in this article in connection with asset and stock sales) the fact that ''a person previously employed by the original employer continues to work in the operation as an employee of the new employer.''

'Result.' Whether a particular ''separation'' should be treated as being a ''result'' of a cessation can raise interesting issues as well. How does normal attrition enter into the analysis? What about an employee who voluntarily quits or retires in anticipation of the cessation, or does so at or about the time of the cessation having previously planned to quit or retire? Would an employee who is involuntarily separated for (arguably) other reasons have to be counted? Must an employee have been employed at the affected facility or in the affected operation to count?

PBGC proposes to address these and similar issues with a general rule and a number of presumptions.[35] The general rule calls for a ''but for'' analysis: the ''result'' test is met if the ''separation would not have occurred when it did if [the cessation] had not occurred,'' regardless of whether the employee separates before, on, or after the cessation date, is employed in the operation that ceased, or is employed at the facility associated with the operation that ceased.

Thus, for example, a separation of an employee employed in an entirely different operation or at an entirely different facility could count, so long as an adequate causal link is established between the cessation and the separation, regardless of when it occurs.

There would be four presumptions:

- *Voluntary cessation; involuntary separation.* The ''result'' test is presumed met if an involuntary separation occurs on or after the date the employer *decides* to cease operations in a voluntary cessation.

- *Voluntary cessation; voluntary separation.* The ''result'' test is presumed met if a *voluntary* separation occurs on or after the date the employer cessation decision in a voluntary cessation *becomes known*.

- *Involuntary cessation.* The ''result'' test is presumed met if a voluntary *or* involuntary separation occurs on or after the date of the event causing the cessation.

- *Employment by new employer.* The ''result'' test is presumed met if a new employer continues or resumes operation at the same or a different facility and employs the employee.

PBGC stated in the preamble that any of the presumptions could be rebutted by appropriate evidence. For the first three presumptions, this could lead to significant fact-specific disputes regarding the reasons for a particular separation. However, insofar as the fourth presumption is concerned (relating to employment by a new employer), it is not clear what kind of ''appropriate evidence'' could persuade PBGC that the presumption has been successfully rebutted.

Determining the 'Active Participant Base.' Questions also abound when determining the active participant base for purposes of the 20-percent threshold test and for purposes of the liability fraction. Do the same rules apply for both purposes? Are participants included even if they are not accruing benefits because the plan was frozen? How does one deal with changes during a (possibly extended) pre-cessation downsizing period, including changes after the date of the employer's decision to cease operations or after the date of the event causing the cessation?

PBGC's proposal is to provide a single set of rules to determine the ''Active Participant Base,''[36] which would be used both as the base number for the 20-percent threshold test and as the denominator for the liability fraction. For these purposes, the same test for ''employment'' would apply as is being proposed for purposes of determining ''separation from employment,'' and whether an individual is a participant in the plan would be determined without regard to whether the individual is accruing benefits under the plan.

The Active Participant Base would be determined immediately before the date of the employer's cessation decision in a voluntary cessation, and immediately before the date of the event causing the cessation in an involuntary cessation. Thus, an earlier decline in the number of active participants, for example where an employer experiences an extended period of downsizing before making a decision to cease an operation, would not count.

[34] *Id.* at 48286, 48292.

[35] *Id.* at 48286–87, 48292.

[36] *Id.* at 48287, 48292.

Enforcement of Section 4062(e). The proposal also includes several provisions relating to reporting and enforcement issues.[37] For example:

- *PBGC investigations*. Responses to PBGC's information requests would be due within a specified period (by the 45th day after the request or, in certain circumstances, by an earlier deadline specified in the request).
- *Determination of 60-day reporting deadline.* The 60-day reporting period for purposes of a Section 4063(a) notice would start on the later of the cessation date and the date the 20 percent threshold is crossed.
- *Disregarding certain affected participants for notice purposes*. For certain notice purposes, the plan administrator would be permitted to disregard affected participants who were not employed at the facility associated with the affected operation.
- *Mandatory forms*. The 60-day notice under Section 4063(a) would have to be provided in accordance with mandatory forms and instructions that specify the information required to be submitted. PBGC noted in the preamble that violations of the notice requirement ''may well warrant section 4071 penalties larger than the 'general' ($25/$50-per-day) penalty, subject to the $1,100-per-day limitation,'' noting that such violations ''may well result in substantial harm to participants and PBGC, especially because of the five-year limitation on maintaining a bond or escrow under ERISA section 4063(c)(2).''
- *Disregarding post-cessation changes*. The plan underfunding determined for Section 4062(e) purposes would be determined without regard to any change in the affected plan's assets or benefit liabilities after the cessation date.
- *Negotiating flexibility*. PBGC would continue to have the authority to negotiate alternative arrangements for satisfying Section 4062(e) liability.
- *Recordkeeping*. The employer and plan administrator would each be required to retain, for a five-year period, records ''that bear on whether there was a section 4062(e) event and on the calculation of liability with respect to the event.''
- *Waivers*. PBGC would have the authority to waive any provision of its 4062(e) regulation ''to accommodate the facts and circumstances of particular cases and promote the equitable and rational interpretation of title IV.'' However, there would be no automatic waivers for small plans, for well-funded plans, or for plans undergoing standard terminations. Hopefully the final rule will provide appropriate automatic waivers, at least in cases where it is clear that PBGC does not need and would not act on a notice informing it of a Section 4062(e) event.

Negotiating Settlements with PBGC

When liability arises under Section 4062(e), it is not self-executing. To enforce it, PBGC could bring a court action. However, PBGC typically seeks a negotiated resolution of Section 4062(e) cases, rather than pursuing the statutory bond or escrow remedies, with settlements that can be similar to those it negotiates under its Early Warning Program (*e.g.*, providing for additional cash contributions, security, or guarantees to protect the pension plan in case it later terminates).

PBGC has considerable flexibility, similar to that enjoyed by private-sector entities, to develop creative approaches to settlement. It also has a fair amount of leverage in Section 4062(e) cases, not only because it could file a lawsuit to enforce the liability, but also, and perhaps more important, because some employers cannot withstand the effect that even a PBGC assertion of liability in a letter could have on loan and other agreements (relating to covenants, notice, default, etc.), on SEC disclosures, on credit ratings, and on current or prospective lenders or investors.

On the other hand, the employer also has considerable leverage if it can reasonably dispute whether the liability has arisen or how much it is, particularly given PBGC's interest in resolving the matter well in advance of the end of the five-year ''shelf life'' of the liability rather than to litigate the issues for most or all of the five-year period. There are also more ''political'' issues that can bear on the resolution of a Section 4062(e) matter, including a presumed desire on the part of PBGC not to insist on onerous terms that could end up triggering an employer failure and the loss of a significant number of American jobs.

The settlement itself will typically aim to satisfy, perhaps through several different means, the full amount of the Section 4062(e) liability, as PBGC tends to resist any ''haggling'' on the amount at issue. Of course, if there is a significant dispute as to what that amount is, PBGC may have to settle for a lesser amount than what it determined if it is to achieve a settlement rather than engage in what could be extended litigation.

A common means of resolving these cases is for the employer to commit to PBGC that it will make additional contributions to the plan in amounts totaling the Section 4062(e) liability amount. These contributions may be made immediately or over a period of several years, and PBGC will insist that the employer not create or increase the amount of any prefunding balance as a result of making the additional contributions. PBGC may give the employer ''credit'' for any additional contributions made after the cessation but before the settlement is signed. In addition, PBGC may treat in essentially the same manner as any ''new'' additional contributions the employer's willingness to ''burn'' an existing funding standard carryover balance or prefunding balance.

Additional contributions are always welcome at PBGC; indeed, some PBGC officials have been known to say, ''I never met a contribution I didn't like.''

Settling for additional contributions provides potential advantages for the employer and for PBGC. For the employer, if cash flow is not a major concern, the long-term ''cost'' of such a settlement is little or nothing, as the employer is essentially paying itself in that every ''extra'' dollar translates into having to pay a dollar less (actually, more than a dollar less because of earnings on the initial dollar) in total for all future plan years. And for PBGC, the extra contributions continue to provide at least some protection after the statutory five-year period has run, so that PBGC would have something to show for its efforts in the event of a distress or involuntary termination sometime shortly *after* the end of the five-year period.

The commitment to make additional contributions may or may not have to be accompanied by security to back it up. And whether or not there is a commitment to make additional contributions (or to burn an existing

[37] *Id.* at 48287–89, 48292–93.

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credit balance), there may be a requirement for security as part of the settlement. The security interest need not be a first priority interest; in appropriate circumstances where there is sufficient value, a silent second (or third, etc.) may well suffice.

A letter of credit is another option that can work, although the costs and limitations on liquidity associated with a letter of credit may make it an unattractive option for the employer.

The stock that one controlled group member holds in another will generally not be viewed by PBGC as having value, given that PBGC has a direct joint-and-several claim against the assets of each controlled group member in the event of a plan termination. However, PBGC may view such stock as having significant value if it is stock of a foreign subsidiary, given the difficulties PBGC itself recognizes in directly pursuing foreign entities based on PBGC's view of ERISA's extraterritorial reach.

For similar reasons, PBGC will typically assign little or no value to a contractual guarantee from a domestic controlled group member, but may view one from a foreign controlled group member as quite valuable, given the relative ease of enforcing contractual as opposed to statutory rights against foreign entities.

In the negotiations, the employer will likely seek to have any obligations terminate at the end of the statutory five-year period, with PBGC pushing for protection beyond that period. Additional contributions, as previously noted, serve to naturally extend the period of protection. The willingness of the employer to extend the period of protection beyond five years may ''buy'' less onerous terms as part of the settlement, as the extension will ordinarily have significant value for PBGC.

In addition, by avoiding entering into an agreement in which PBGC's negotiated protection abruptly disappears at the five-year mark, the employer will also avoid the risk that PBGC might later act to terminate the plan involuntarily just before its negotiated protection disappears.

Conclusion

An employer contemplating a downsizing or an asset or stock sale has a variety of costs and other considerations to take into account. If the employer has a PBGC-covered pension plan, particularly if (as is usually the case) it is underfunded on a PBGC plan termination basis, it is important to evaluate whether the downsizing or sale might trigger Section 4062(e) liability, as this liability could end up being the largest one the employer must face.

With careful planning, it may be possible to structure the downsizing or sale so that the liability does not arise, or to take steps to minimize the liability. And to the extent liability remains, there are ways of settling it that, if properly structured, can be relatively pain-free for the employer. The key is advance planning so that there will be no surprises.