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PBGC Proposes Alternative Liability Calculation for Facility Shutdowns

BY HAROLD J. ASHNER

On Feb. 25, 2005, the Pension Benefit Guaranty Corporation issued a proposed rule (70 Fed. Reg. 9258; 38 PBD, 9/28/05) that would create a new method of calculating liability when there is a cessation of operations at a facility under the Employee Retirement Income Security Act Section 4062(e). That provision consists of a single sentence, one 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 §§ 4063, 4064, and 4065 shall apply.

The statute is confusing because it ties the liability for a cessation of operations to the liability rules that apply when a substantial employer withdraws from a multiple-employer plan. Those liability rules work when there are multiple employers but not when there is a cessation of operations involving only one employer. This article summarizes and analyzes the PBGC's proposal to establish a liability formula that is designed to work in this ''one-employer'' context.

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Current Law. If an event described in ERISA Section 4062(e) occurs—in simplified terms, if more than 20 percent of a plan's active participants lose their jobs because of a facility shutdown—the statutory language refers the reader to the rules governing the withdrawal of a substantial employer from a multiple-employer plan. A multiple-employer plan is unlike a multiemployer plan in that it is not collectively bargained and is unlike a typical single-employer plan in that it is maintained by at least two unrelated employers. It is, however, considered to be a type of single-employer plan notwithstanding that multiple unrelated employers maintain it.[1]

In the case of a substantial employer (one whose required contributions to the plan for two consecutive plan years out of the last three plan years totaled at least 10 percent of all required contributions to the plan for those years) that withdraws from a multiple-employer plan, ERISA Section 4063 imposes liability on the withdrawing employer. The liability, which represents the withdrawing employer's share of the plan's total underfunding in the event of plan termination, is to be paid to PBGC and held in escrow in case the plan terminates within five years after the date of the withdrawal.

- If the plan terminates within five years, the escrowed payment is added to the plan's assets.
- If the plan is still ongoing at the end of the five-year period, the escrowed payment is returned to the withdrawn employer.

[1] See ERISA §§ 4001(a)(3), (15).

In lieu of making the payment to PBGC, the withdrawing employer may be required to furnish a bond to PBGC in an amount not exceeding 150 percent of the Section 4063(b) liability, with the bond ultimately realized upon or cancelled depending on whether the plan terminates within five years.

The amount of liability under Section 4063(b) is calculated by first determining the total amount of the plan's ''unfunded benefit liabilities'' (based on PBGC assumptions) as if the plan had terminated on the date of the withdrawal. A portion of that amount is then allocated to the withdrawing employer in proportion to that employer's share of the required contributions to the plan for the last five plan years ending before the date of the withdrawal. Thus, the numerator of the allocation fraction is the total of required contributions of the withdrawing employer over the five-year period, and the denominator is the total of all required contributions over that same five-year period.

When there is a Section 4062(e) event involving only one employer, the cross-reference to the multiple-employer rules governing liability for withdrawal simply does not work. The allocation fraction, taken literally, equals one because its numerator and denominator are the same. Yet the employer presumably should not be liable for the full amount of the plan's termination liability based on a drop of just over 20 percent in the number of the plan's active participants. Fortunately, ERISA Section 4063(b) allows PBGC ''to determine [the section 4063(b)] liability on any other equitable basis prescribed by the [PBGC] in regulations.'' It is under this explicit statutory authority that the PBGC issued its Feb. 25, 2005, proposed rule.

The PBGC Proposal. Under the proposed rule, the starting point for determining the liability upon the occurrence of a Section 4062(e) event would be the plan's ''unfunded benefit liabilities'' (based on PBGC assumptions), determined ''immediately after'' the date of the cessation of operations under Section 4062(e) rather than on the date of any ''withdrawal'' under Section 4063. (The ''immediately after'' language would serve to capture any shutdown or similar benefits triggered by the cessation.) That total liability would then be multiplied by an allocation fraction.

The proposed allocation fraction is based on a pure ''head count'' approach: the numerator would equal ''the number of the employer's employees who are participants under the plan and are separated from employment as a result of the cessation of operations'' and the denominator would equal ''the total number of the employer's employees who were participants under the plan before taking into account the cessation of operations.'' Thus, if the cessation results in 3,000 of 10,000 active participants being separated from employment, and the total plan underfunding if the plan had terminated immediately after the date of the cessation would be $10 million, the employer's liability under ERISA Section 4062(e), based on the proposed rule, would be $3 million (3,000/10,000 × $10 million). The proposed approach tracks the approach PBGC has generally applied on a case-by-case basis through its settlement authority.

PBGC described the proposed method as ''simple,'' ''practical,'' ''equitable,'' and ''transparent,'' noting that it ''will allow plan sponsors who experience a section 4062(e) event (or believe they may experience a section 4062(e) event) to readily determine their liability (or expected liability).'' In many cases, the proposed approach will work quite well. However, the simplicity of the proposed ''head count'' approach could prove to be problematic where the separated employees, on average, have significantly less (or more) valuable benefit liabilities—and represent significantly less (or more) of the contribution base for the plan—than the remaining active participants. Consider, for example, a situation where the separated employees are predominantly junior employees with very small pension benefits; in such a case, the proposed allocation fraction could overstate the liability by treating them the same as the remaining active participants.

The simplicity of the proposed approach assumes that it is easy to determine the occurrence of a Section 4062(e) event, its date, the number of active participants separated as a result, and the total number of active participants. These determinations are not always so easy to make, particularly given the broad array of interpretive issues under ERISA Section 4062(e) that the proposed rule does not address.

Unresolved Interpretive Issues. The single sentence that makes up the entirety of ERISA Section 4062(e) raises several questions. For example, what is a ''facility in any location'' where there are two or more geographically proximate buildings at which the same or related ''operations'' are conducted? What if the buildings are far removed from each other geographically but the work performed in them makes up an integrated set of ''operations.'' Can there be two ''facilities'' within a single building? Is the cessation of one set of-''operations'' enough to trigger Section 4062(e) liability where other ''operations'' continue at the same facility? If so, what constitutes ''operation'' that are sufficiently distinct from other ''operations'' at the same facility? Must the ''cessation'' of the operations (or of all operations) at the facility be a complete cessation, without regard to the completion of any work in progress? What is the date of a ''cessation'' when it occurs in two or three stages, or gradually over an extended period of time? Can a cessation of operations at Facility A ''result'' in the separation of an employee at Facility B (e.g., a warehouse stocking parts for the operations at Facility A)? What about employees who separate for reasons not clearly tied to the cessation (including normal attrition)? At what point is an employee to be treated as having been ''separated'' in the context of layoffs, recall rights, etc.? Under what circumstances, if any, might an asset sale constitute a Section 4062(e) event? (Several early PBGC opinion letters concluded that there was no Section 4062(e) event in the context of the particular asset sales presented for consideration.)[2] The proposed rule leaves these and other issues for PBGC to address as they arise on a case-by-case basis.

Of course, there are many situations in which these issues do not arise and for which the proposed approach should be easy to apply. For example, where a separate and distinct facility undergoes a complete shutdown on a single date, PBGC's proposal could significantly expedite the determination of the resulting liability.

[2] *See*, e.g., PBGC Opinion Letters 76-52, 77-147, 78-29, and 82-29.

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Conclusion. The practitioner would be well-advised to be familiar with ERISA Section 4062(e) and the issues it raises. PBGC's proposal appears to be aimed at making this provision a more effective tool for limiting its exposure. Given PBGC's current financial condition, it is reasonable to expect PBGC to use this tool more frequently and aggressively in the future—particularly once this proposal is implemented.