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Dealing with the Pension Benefit Guaranty Corporation

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Some say that the PBGC is in crisis. That may be an overstatement, but the PBGC clearly has seen better times. Its universe of ongoing insured pension plans has been on the decline for many years. Its inventory of failed, PBGC-trusted pension plans has been growing by leaps and bounds. And its financial position, which just a few years ago appeared so strong that there was talk of an impending “premium holiday,” has dropped precipitously. Today, the

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talk instead is of sharply increased premiums, along with sharply increased funding obligations, as part of the ongoing “save the PBGC” legislative debate. For practitioners and their clients, PBGC issues are arising more often, with more at stake, than ever before.

This article provides the practitioner with guidance on dealing with a wide variety of matters arising under the PBGC’s single-employer plan termination insurance program — plan coverage, premiums and related audits and penalties, standard terminations and related audits, information penalties, reporting and disclosure requirements, “Early Warning Program” negotiations, distress and involuntary terminations, and bankruptcy. However, to deal effectively with the PBGC, it is helpful to understand the issues it is grappling with, and this article therefore begins with a brief overview of the PBGC’s current challenges.

STATE OF THE PBGC

The PBGC was established by ERISA in 1974 as a federal government corporation, with a Board of Directors consisting of the Secretary of Labor, who chairs the Board, and the Secretaries of Treasury and Commerce.² Its three statutory purposes are: (1) to encourage the

² ERISA §4002(d); 29 USC §1302(d).

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continuation and maintenance of voluntary private pension plans, (2) to provide timely and uninterrupted payment of pension benefits, and (3) to keep pension insurance premiums at the lowest levels consistent with its statutory responsibilities.³

As a government corporation, the PBGC is not funded by general tax revenues. Instead, its funding comes from four sources: mandatory premiums paid for all insured plans, assets of the plans it takes over, recoveries (generally only a few cents on the dollar) from employers in bankruptcy, and earnings on invested assets.⁴ Significantly, the PBGC is not backed by the “full faith and credit” of the U.S. government. This means that — as a legal matter — if the PBGC were to run out of money and be unable to issue pension checks, taxpayers would not be on the hook. Of course, political considerations may well lead to a different result.

The Ongoing Universe: Declining Coverage

The private sector has seen a dramatic drop in the number of PBGC-insured single-employer defined benefit pension plans. In Fiscal Year (FY) 1985, the number of such plans peaked at 112,000.⁵ By FY 2005, that number had dropped to under 29,000.⁶ But over this same time period, the number of insured participants actually grew, from under 30 million in 1985⁷ to over 34 million in 2005.⁸ The numbers have been going in different directions because the bulk of the drop has been among the smallest plans, with the largest plans actually growing in number. The number of plans with fewer than 100 lives dropped from 90,000 in 1985 to 18,000 in 2004, while the number of mega-plans with 10,000 or more participants nearly doubled in number, from 354 plans in 1985 to 628 plans in 2004.⁹

Unfortunately, the increases in the number of covered participants and in the number of mega-plans are not signs of a healthy, vibrant system. All of the growth in the number of insured participants, which in turn contributes to the growth in the number of the largest insured plans, was due to an increase in the number of *inactive* participants — terminated vested

participants, retirees, and surviving spouses and other beneficiaries — rather than to any increase in the number of active workers participating in defined benefit plans. Defined benefit coverage among active participants has declined significantly, as the defined contribution plan has become the plan of choice in the private sector. In 1985, the PBGC’s single-employer program covered nearly 25% of the nation’s private-sector wage and salary workers; by 2002, that percentage had dropped to 15%.¹⁰ And by 2002, there were more inactive participants than active participants covered by the PBGC’s single-employer insurance program.¹¹

The decline in defined benefit plan coverage may be far from over. Many of the employers that have not exited the system are in it only because they cannot get out. To exit the system voluntarily, absent bankruptcy or some other form of severe financial distress, the employer must fund up the plan in a standard termination to cover all benefits. Many employers cannot afford to do that and are instead freezing their plans, cutting off any further benefit accruals, and hoping that one day the economy will help them meet all plan obligations.

The PBGC-Trusted Universe: Increasing Workload

At the end of FY 2005, the PBGC was responsible for paying current and future retirement benefits to 1.3 million people in about 3,600 terminated plans.¹² Each new plan the PBGC takes over represents a significant workload challenge. Over the 31-year period from the PBGC’s September 1974 establishment to the end of FY 2005, the PBGC had taken over, on average, 116 single-employer pension plans per year.¹³ The PBGC has beaten its average over the past several years, taking over 144 plans in FY 2002,¹⁴ 152 plans in FY 2003,¹⁵ 178 plans in FY 2004,¹⁶ and 138 plans in FY 2005.¹⁷ From a workload perspective, however, the number of plans the PBGC takes over is not nearly as significant as the number of participants in those plans.

¹⁰ *Id.* at Table S-33. (Post-2002 data are not yet available.)

¹¹ *Id.* at Table S-32. (Post-2002 data are not yet available.)

¹² PBGC *FY 2005 Performance and Accountability Report* at p. 2.

¹³ See *2004 Pension Insurance Data Book*, Table S-8 (3,469 plans from FY 1975 through FY 2004); FY 2005 data (138 plans) provided by the PBGC’s Communications and Public Affairs Department.

¹⁴ PBGC *FY 2002 Annual Report* at p. 1.

¹⁵ PBGC *FY 2003 Annual Report* at p. 2.

¹⁶ PBGC *FY 2004 Annual Report* at p. 8.

¹⁷ Data provided by the PBGC’s Communications and Public Affairs Department.

³ ERISA §4002(a); 29 USC §1302(a).

⁴ See generally ERISA §§4005, 4042; 29 USC §§1305, 1342.

⁵ *2004 Pension Insurance Data Book*, Table S-31.

⁶ PBGC *FY 2005 Performance and Accountability Report* at p. 6.

⁷ *2004 Pension Insurance Data Book*, Table S-30.

⁸ PBGC *FY 2005 Performance and Accountability Report* at p. 6.

⁹ *2004 Pension Insurance Data Book*, Table S-30. (FY 2005 data are not yet available.)

In FY 2001, the PBGC took in a record-breaking 89,000 participants.¹⁸ That all-time high did not last very long, as the PBGC more than doubled its record the very next year, taking in 187,000 participants.¹⁹ Yet another record was set in FY 2003 when the PBGC took in 206,000 participants.²⁰ FY 2004 was another very busy year, with 147,500 participants added to the PBGC's rolls.²¹ And FY 2005 saw a new all-time record, with the PBGC taking in 269,000 participants.²²

This dramatically increasing number of participants translates into a monumentally increasing PBGC workload. Determining the benefits each participant is entitled to requires the PBGC to interpret current and, in many cases, previous plan provisions; to gather and review plan records (which are often incomplete or in disarray); to make determinations about the values of bankruptcy recoveries; to value the plan's assets and liabilities; to allocate plan assets to plan benefits in accordance with the priority categories of ERISA §4044; and, ultimately, to determine the levels of benefits that are guaranteed or funded and thus payable under the termination insurance program.

The benefit determination process can take considerable time and effort. In FY 2000, for example, it took the PBGC on average almost five years from when it took over a plan to issue final benefit determinations to the plan's participants.²³ This does not mean that participants are out of pay status for five years; to the contrary, those in pay status continue to be paid through and beyond PBGC trusteeship, although their benefits may be cut back to estimated levels,²⁴ and those eligible to enter pay status are paid on an estimated basis shortly after they submit their applications to the PBGC.

The PBGC has made a commitment to issue its final benefit determinations within one to three years after it takes over a plan and has been making good on that commitment in recent years. In FY 2003 and FY 2004, for example, the PBGC averaged 2.2 years between the date of trusteeship and the date of its final benefit determination.²⁵ The PBGC now faces the daunting task of continuing to improve in this area, or at least of maintaining its current benefit determination timing.

¹⁸ PBGC FY 2001 Annual Report at p. 1.

¹⁹ PBGC FY 2002 Annual Report at p. 1.

²⁰ PBGC FY 2003 Annual Report at p. 7.

²¹ PBGC FY 2004 Annual Report at p. 3.

²² Data provided by the PBGC's Communications and Public Affairs Department.

²³ PBGC FY 2000 Annual Report at p. 9.

²⁴ See 29 CFR Part 4022, Subpart D.

²⁵ PBGC FY 2004 Annual Report at p. 8. (FY 2005 data are not yet available.)

The PBGC's Financial Condition: Deterioration

The PBGC operated in a deficit position under its single-employer program for its first 21 years, with the deficit peaking in FY 1993 at almost \$3 billion.²⁶ Those deficit years were followed by some very good years. From FY 1996 through FY 2001, the PBGC was in a surplus position,²⁷ with the surplus peaking at \$9.7 billion in FY 2000.²⁸ This was a decidedly up period for the stock market, with the PBGC participating more heavily in equities than it currently does. More importantly, the PBGC did not face any major claims from large underfunded plans during those years.

Things took a turn for the worse, and in a big way, in FY 2002, when the PBGC went from a surplus of \$7.7 billion to a deficit of \$3.6 billion.²⁹ As the PBGC pointed out at the time, this \$11.3 billion loss was more than five times greater than any previous one-year loss in the PBGC's 28-year history.³⁰ And the PBGC also then noted that it would take 12 years of premium revenue to make up for this one-year loss.³¹ The FY 2002 deficit of \$3.6 billion was an all-time record for the PBGC.³²

The financial deterioration did not stop in FY 2002. FY 2003 saw the \$3.6 billion all-time record deficit more than triple, to \$11.2 billion.³³ Then, in FY 2004, the deficit more than doubled, to \$23.3 billion.³⁴ The FY 2005 deficit dropped a bit, to \$22.8 billion,³⁵ but the PBGC was quick to point out when it released that number on November 15, 2005, that if very recent events (those between the September 30, 2005, end of FY 2005 and the release date of November 15, 2005) had occurred prior to the end of FY 2005, the deficit would have been \$25.7 billion (i.e., yet another all-time record deficit).³⁶

The deficit was caused in part by the same "perfect storm" that the PBGC's insured plans have faced: poor investment experience reducing current assets,

²⁶ PBGC Annual Reports (FY 1975 – FY 1995); 2004 Pension Insurance Data Book, Figure 1 and Table S-1.

²⁷ 2004 Pension Insurance Data Book, Table S-1.

²⁸ PBGC FY 2000 Annual Report at p. 1.

²⁹ PBGC FY 2002 Annual Report at p. 1.

³⁰ Statement of Steven A. Kandarian, Executive Director, PBGC, before Senate Finance Committee (Mar. 11, 2003).

³¹ *Id.*

³² PBGC Annual Reports (FY 1975 – FY 2002); 2004 Pension Insurance Data Book, Figure 1 and Table S-1.

³³ PBGC FY 2003 Annual Report at p. 2.

³⁴ PBGC FY 2004 Annual Report at p. 2.

³⁵ PBGC FY 2005 Performance and Accountability Report at p. 2.

³⁶ *Id.* at pp. 4, 48; PBGC Press Release, *PBGC Releases Fiscal Year 2005 Financial Results* (Nov. 15, 2005).

coupled with declining interest rates increasing the present value of future benefits. But the major reason for the growing deficit was a very small number of very large claims from severely underfunded plans. The PBGC's financial position is driven largely by a few catastrophic claims. Indeed, although the PBGC has taken over about 3,600 failed plans involving thousands of employers, the employers representing just the top 10 claims account for well over half of the PBGC's historical claims experience.³⁷

The PBGC's \$22.8 billion deficit does not pose an immediate liquidity crisis. According to the PBGC's *FY 2005 Performance and Accountability Report*, "the Corporation has sufficient liquidity to meet its obligations for a number of years."³⁸ Although the PBGC's \$56.5 billion in assets was exceeded by over \$79 billion in liabilities,³⁹ the liabilities are paid out over many years, in part because the PBGC pays lump sum benefits only in the case of de minimis benefits. The absence of an immediate liquidity problem, however, in no way suggests that the PBGC is in good shape. As the PBGC also noted in its FY 2005 report, the single-employer program (like the smaller multi-employer program) does not "at present [have] the resources to fully satisfy PBGC's long-term obligations to plan participants."⁴⁰

Only completed and "probable" plan terminations are reflected in the PBGC's \$22.8 billion deficit. There is exposure, as well as risk, above and beyond the current deficit. Total underfunding in the PBGC's ongoing single-employer plan insured universe hit a record-breaking \$150 billion in FY 2001. The number climbed to over \$450 billion by FY 2004⁴¹ and remained unchanged in FY 2005.⁴² Much of this exposure is accompanied by minimal risk in that the sponsoring employer clearly has the financial wherewithal to fund the plan over time. But a growing portion of this exposure for total underfunding is in plans that, by PBGC standards, also involve significant risk, i.e., generally, plans maintained by employers with below-investment-grade credit ratings. This portion of total underfunding, which the PBGC refers to as its "reasonably possible" exposure, hit an all-time high of

³⁷ 2004 *Pension Insurance Data Book*, Figure 2 (data through FY 2004) and PBGC *FY 2005 Performance and Accountability Report*.

³⁸ PBGC *FY 2005 Performance and Accountability Report* at p. 12.

³⁹ *Id.* at p. 2.

⁴⁰ *Id.* at p. 12.

⁴¹ PBGC *FY 2004 Annual Report* at p. 16.

⁴² PBGC *FY 2005 Performance and Accountability Report* at p. 5.

\$35 billion in FY 2002,⁴³ with successive new all-time highs in FY 2003, FY 2004, and FY 2005 of \$85 billion,⁴⁴ \$96 billion,⁴⁵ and \$108 billion,⁴⁶ respectively.

The future of the PBGC's deficit has been the subject of much conjecture and debate. According to a "stochastic" (i.e., random or probabilistic) modeling system, the PBGC's Pension Insurance Modeling System ("PIMS"), it is probable that the deficit will grow. PIMS assigns probabilities to various potential future loss levels by running thousands of simulations. According to PIMS, in constant 2004 dollars, starting with the FY 2004 deficit of \$23.3 billion, the probability that the deficit will turn into a surplus in 2014 is only 2%. On the other hand, there is a 10% probability that the surplus will then be \$49.8 billion or more. The median PIMS outcome in 2014 is about \$27 billion, and the mean outcome is about \$30 billion, both in 2004 dollars.⁴⁷

RESEARCHING PBGC ISSUES

When researching PBGC issues, it is important to go beyond the obvious sources of statutes, regulations, case law, and PBGC opinion letters. A great deal of important guidance can be found in other sources.

One key source that is well-known in the actuarial community but not nearly as familiar in the legal community is the PBGC "Blue Book." The Blue Book, which is analogous to the IRS "Gray Book" and is prepared annually in conjunction with the Enrolled Actuaries Meeting, consists of a summary of questions asked by the Enrolled Actuaries Program Committee and the answers provided by PBGC staff. The actuarial focus of the Blue Book should not frighten lawyers, as the vast majority of the questions and answers deal with issues that are just as suitable for lawyers as they are for actuaries. The Blue Book guidance is informal at best and comes complete with a strong disclaimer that would allow the PBGC to adopt conflicting positions.⁴⁸ However, the author is unaware of any instance in which the PBGC has re-

⁴³ PBGC *FY 2002 Annual Report* at pp. 17-18.

⁴⁴ PBGC *FY 2003 Annual Report* at p. 26.

⁴⁵ PBGC *FY 2004 Annual Report* at p. 16.

⁴⁶ PBGC *FY 2005 Performance and Accountability Report* at p. 4.

⁴⁷ The PIMS results are discussed in the PBGC *FY 2004 Annual Report* at p. 11-12.

⁴⁸ For example, the 2005 PBGC Blue Book states (at p. 2) as follows: "The summary responses to the questions are intended to reflect as accurately as possible the statements made by the government representatives. However, those responses are merely the current views of the individuals and do not represent the positions of the Pension Benefit Guaranty Corporation or of any other gov-

nounced any Blue Book guidance. Thus, Blue Book guidance, while not carrying any legal weight, is likely to reflect the PBGC's views. All Blue Books (as of this writing, those for 1998 and 2000 through 2005) are available on the PBGC's website (www.pbgc.gov).

Another important source of PBGC guidance is its "Technical Updates," also available on the PBGC's website. Technical Updates carry no disclaimer and represent the PBGC's official position. The PBGC has used these updates for various purposes, including providing reporting relief⁴⁹ and interpretive guidance.⁵⁰ The website also includes FAQs that provide interpretive guidance in the areas of standard terminations, missing participants, premiums, and guaranteed benefits, as well as filing instructions and related guidance for these and other areas (including reportable events, notices of missed contributions exceeding \$1 million, and annual employer reporting). Another useful source, but one that is not always easy to research, is preambles to the PBGC's proposed and final rules. Preambles published on or after July 1, 1996, appear on the PBGC's website.

PLAN COVERAGE

A defined benefit plan is covered by Title IV of ERISA if it meets certain tax-qualification requirements and does not fall within any of a number of statutory exemptions from coverage.⁵¹ Depending on the circumstances, a plan may be seeking a determination of coverage (to qualify for the PBGC's guarantee) or of non-coverage (to avoid the premium obligation or to qualify for a refund of premiums already paid). A PBGC initial determination of coverage is subject to a right to request reconsideration, while a non-coverage determination comes with the somewhat more elaborate right to appeal to the PBGC's Appeals Board.⁵²

Whether a plan is covered affects both the obligation to pay premiums and the applicability of the

ernmental agency, and cannot be relied upon by any person for any purpose. Moreover, the PBGC has not in any way approved this booklet or reviewed it to determine whether the statements herein are accurate or complete."

⁴⁹ See, e.g., Technical Updates 97-6 (waiving reporting of missed quarterly contributions for certain plans) and 02-1, 04-2, and 04-3 (providing reporting relief in connection with statutory interest rate changes made for premium determination purposes).

⁵⁰ See, e.g., Technical Updates 95-3 (providing interpretive guidance on reportable events requirements pending further rule-making) and 00-4 (providing interpretive guidance on determining whether the full funding limit exemption from the variable-rate premium applies).

⁵¹ ERISA §4021, 29 USC §1321.

⁵² 29 CFR §4003.1(a), (b)(1), (b)(5).

PBGC's benefit guarantee. If the goal is to get a premium refund (e.g., where premiums have been paid on behalf of a plan whose coverage status was unclear), it is important to be mindful of the applicable statute of limitations, which generally runs for six years.⁵³ The PBGC had not always refused to pay premium refund claims that fall outside the limitations period but in 1993 published a Federal Register notice making clear that it would do so in the future.⁵⁴ If the goal is to qualify for the guarantee, on the other hand, there is clearly a need to plan ahead, as the PBGC interprets the Title IV guarantee provisions to call for a five-year phase-in of the guarantee that starts when a plan first becomes covered by Title IV, regardless of how long the plan was in existence as a non-covered plan.⁵⁵

Some plans can go in and out of coverage, while other plans remain covered even if the circumstance that initially caused them to be covered no longer exists. For example, a plan that is "established and maintained exclusively for substantial owners" is exempt from coverage.⁵⁶ However, the PBGC has interpreted "established and maintained" for this purpose as meaning "maintained," and has thus recognized that a plan can go from being covered (when it is maintained for at least one non-substantial owner) to non-covered (when it is maintained only for one or more substantial owners) and back again.⁵⁷ On the other hand, a professional services employer plan is exempt if it "does not at any time after September 2, 1974, have more than 25 active participants in the plan;"⁵⁸ once it has its 26th active participant, it will remain covered even if the active participant count drops below 26 in the future.

PREMIUMS AND RELATED AUDITS AND PENALTIES

The annual premium obligation for a single-employer plan consists of a flat-rate premium of \$19 per participant (subject to a possible increase to \$30 per participant effective in the 2006 plan year, with adjustments for inflation thereafter, based on budget legislation pending when this article went to press) and a variable-rate premium of 0.9% of a plan's underfunding measured using special PBGC premium

⁵³ ERISA §4003(f)(5), 29 USC §1303(f)(5).

⁵⁴ 58 Fed. Reg. 63406 (Dec. 1, 1993); see also, e.g., 2005 Premium Payment Package instructions at p. 17.

⁵⁵ See 2002 PBGC Blue Book, Q&A-13.

⁵⁶ ERISA §4021(b)(9), 29 USC §1321(b)(9).

⁵⁷ See PBGC Op. Ltr. 90-6 and Q&A-16 of 2000 PBGC Blue Book.

⁵⁸ ERISA §4021(b)(13); 29 USC §1321(b)(13).

assumptions.⁵⁹ Given recent legislative proposals, it is highly likely that both components of the premium will be increasing significantly.

The variable-rate premium calculation is important not only because it affects how many premium dollars must be paid but also because it affects the applicability of a number of reporting and disclosure requirements. For example, many of the post-event reporting requirements under the PBGC's reportable events regulation contain waivers that are tied to the level or amount of a plan's underfunding on a PBGC premium (or modified) basis.⁶⁰ The thresholds for advance reporting⁶¹ and for annual employer reporting⁶² are also tied to the variable-rate premium calculation. And a Participant Notice is required if a variable-rate premium is payable, unless the plan meets a funding-related test tied to the Deficit Reduction Contribution rules.⁶³ Even a relatively small difference in the variable-rate premium calculation can make the difference between having, and not having, a reporting or disclosure obligation.

Detailed guidance on the full range of interpretive issues relating to the determination of the flat-rate and variable-rate premium is beyond the scope of this article. However, the PBGC Blue Book contains extensive guidance on these issues, more so than on any other single set of PBGC issues, and is worth consulting.

When dealing with corporate transactions involving plan mergers and spinoffs, it is important to keep the PBGC premium consequences in mind. Certainly, there will often be business considerations that drive the structure and timing of any plan-related transfers, but in some cases, it may be possible to save premiums without sacrificing any business goals. For example, under the PBGC's rules governing "duplicate" and "gap" premiums, if a plan merger involving two plans — a calendar-year plan and a plan with an October 1 plan year cycle — is to become effective on December 1, there is a nine-month period of "duplicate" premiums if the calendar-year plan is the surviving plan, and a nine-month "gap" in premiums if the October 1 plan is the survivor.⁶⁴ Similarly, if two plans — a calendar year plan and a fiscal year plan — have always qualified for the full funding limit ex-

emption from the variable rate premium and merge together effective January 1, the plan qualifies for the full funding limit exemption if the calendar-year plan is the survivor, but may not qualify if the fiscal year plan is the survivor.⁶⁵

Failure to pay PBGC premiums on time is rewarded with a penalty. The PBGC's penalty structure is designed to encourage voluntary compliance. The penalty rate is one percent for each month (or partial month) the premium is overdue with respect to amounts that are paid on or before the date the PBGC issues a notice that there is or may be a premium delinquency, and that includes a notice initiating a premium audit.⁶⁶ Once such a notice is issued, any outstanding premium no longer qualifies for the one percent monthly rate. Instead, the penalty rate is five percent per month for all months, going back to the original payment due date.⁶⁷ Thus, playing the "audit lottery" can be risky, as the penalty retroactively quintuples once the PBGC issues an audit notice.

The PBGC may waive a penalty, in whole or in part, based on a showing of reasonable cause.⁶⁸ In 2001, the PBGC published guidance on reasonable cause determinations in a *proposed* statement of policy.⁶⁹ Although that proposed guidance has not yet been finalized, PBGC staff decisions are likely to conform to it.⁷⁰ Significantly, the proposed guidance provides that the reasonable cause determination will focus not just on the actions or omissions of the responsible person, but also on those of that person's outside advisors.⁷¹ Thus, under the proposal, the responsible person would be unlikely to qualify for a reasonable cause waiver if an outside advisor was at fault and lacked reasonable cause, even if the responsible person exercised due diligence in selecting and monitoring the outside advisor.⁷²

The PBGC audits premium filings, preferring to refer to these audits as "premium compliance evaluations."⁷³ Some plans are selected on a random basis, whereas others are selected based on a screening process designed to identify premium filings that are

⁵⁹ See Q&A-8 of the 2002 PBGC Blue Book.

⁶⁰ 29 CFR §4007.8(a)(1)(i).

⁶¹ 29 CFR §4007.8(a)(1)(ii).

⁶² 29 CFR §4007.8(c).

⁶³ 66 Fed. Reg. 2856 (Jan. 12, 2001).

⁶⁴ The response to Q&A-18 of the 2001 PBGC Blue Book states that the proposal "is largely reflective of the PBGC's current practices" and that "it is likely that current case-by-case penalty determinations will be generally consistent with the proposal."

⁶⁵ 66 Fed. Reg. at 2860.

⁶⁶ *Id.*

⁶⁷ PBGC Fact Sheet on *Premium Compliance Evaluation Program* (available at www.pbgc.gov).

⁵⁹ ERISA §4006(a)(3); 29 USC §1306(a)(3); 29 CFR §§4006.3, 4.

⁶⁰ 29 CFR §§4043.27(c)(2), .29(c)(3), .30(c)(3), .31(c)(5), and .34(c)(3).

⁶¹ ERISA §4043(b)(1), 29 USC §1343(b)(1); 29 CFR §4043.61.

⁶² ERISA §4010(b)(1), 29 USC §1310(b)(1); 29 CFR §4010.4(a)(1), (b).

⁶³ ERISA §4011, 29 USC §1311; 29 CFR §4011.3.

⁶⁴ See 53 Fed. Reg. 39200, 39205 (Oct. 5, 1988); see also Q&A-8 of the 1998 PBGC Blue Book.

likely to have errors. For example, large annual fluctuations in the participant count or significant discrepancies between information reported on PBGC premium forms and information reported on Form 5500 may trigger an audit. The PBGC has provided some guidance, in the form of "Practices to Consider," to maximize the likelihood of surviving an audit:

- Maintain detailed records supporting the number of participants reported (e.g., maintain required participant records, keep a list of specific participants for whom premiums were paid, update baseline participant count information regularly);
- Maintain records regarding the plan's exemption from or calculation of the variable-rate premium (e.g., plan asset valuations, actuarial worksheets);
- Perform periodic reviews of payroll and plan data to verify which employees are plan participants;
- Compare the number of participants reported to the PBGC with the number of participants included in the actuarial valuation and analyze differences;
- Document reasons for significant changes to participant counts or vested benefit liabilities; and
- Review comparable information reported on PBGC premium forms and the Form 5500 to identify obvious errors.⁷⁴

STANDARD TERMINATIONS AND RELATED AUDITS

Successfully completing a standard termination, at least from a procedural standpoint, has become much easier to do since the PBGC simplified its standard termination regulations effective January 1, 1998.⁷⁵ Before these rules were put in place, the PBGC nullified hundreds of attempted standard terminations each year, mostly for procedural defects, and the process then had to start anew. Now there is more time to complete various steps, along with flexibility for the plan administrator to cure (or for the PBGC to overlook) procedural deficiencies. Also, the PBGC's Standard Termination Filing Instructions, which are available on the PBGC's website, provide simple, step-by-step procedural guidance. Procedural nullifications by the PBGC have become a rarity.

It is, of course, still possible to qualify for a procedural nullification. A somewhat more common occur-

rence is a late post-distribution certification (certifying that the standard termination distribution has been properly completed) that results in a penalty.⁷⁶ The most common problem area in standard terminations today, however, is of a more substantive nature: audit findings that distributions have not been properly completed.

The PBGC has an active standard termination audit program. If a plan has 500 or more participants, the chances of being selected for audit are 100%; smaller plans may be selected either on a random basis or because the PBGC has reason to believe there may be a problem (e.g., based on a complaint by a plan participant or practitioner).⁷⁷ Whatever the chances of audit may be, it is generally best to have any audit done sooner rather than later. The PBGC selects plans to audit on a quarterly basis, in January, April, July, and October, from among those plan terminations for which the PBGC has closed its case during the preceding calendar quarter, and generally closes a case within a few days after receiving the post-distribution certification.⁷⁸ Filing the post-distribution certification in time to make the quarterly cutoff should not have any effect on the chances of audit but should virtually assure that any audit is done sooner rather than later, a good result for all concerned.

When completing a distribution in a standard termination, doing right by the IRS does *not* necessarily mean doing right by the PBGC. For IRS purposes, it is often entirely appropriate to rely on (for benefit determination purposes) a plan amendment adopted after the plan's termination date but during an applicable remedial amendment period. The PBGC, on the other hand, has a special rule that disregards such post-termination amendments to the extent they decrease participants' benefits or restrict or eliminate benefit forms.⁷⁹ Although the PBGC's regulation allows such amendments to be taken into account for benefit determination purposes "to the extent . . . the decrease is necessary to meet a qualification requirement under section 401(a) of the Code,"⁸⁰ the PBGC has in practice interpreted that narrowly, treating (for example) a post-termination amendment that replaces PBGC rates with GATT rates as ineffective to the extent it drops the PBGC rates (because dropping the

⁷⁴ *Id.*

⁷⁵ 62 Fed. Reg. 60424 (Nov. 7, 1997).

⁷⁶ Although the post-distribution certification is due within 30 days after the distribution is completed, the PBGC will assess a penalty for a late post-distribution certification only to the extent it is filed more than 90 days after the deadline for completing the distribution. See ERISA §4041(b)(3)(B), 29 USC §1341(b)(3)(B); 29 CFR §4041.29.

⁷⁷ See Q&A-12 of the 2001 PBGC Blue Book.

⁷⁸ See *id.* at Q&A-13.

⁷⁹ 29 CFR §4041.8(a).

⁸⁰ 29 CFR §4041.8(c)(1).

PBGC rates is not “necessary” to meet tax qualification requirements). And having a favorable determination letter from the IRS is no assurance of a clean PBGC audit, as the PBGC takes the position that it is not bound by such a letter.⁸¹

The most common error found in PBGC standard termination audits is failure to calculate and pay proper lump sum amounts. In many cases, the failure is due to the distribution being unexpectedly delayed, with the annuity starting date moving to a new stability period having a lower applicable interest rate, but the lump sum is not recalculated to reflect that lower rate. Another common lump sum calculation error involves disregarding or misapplying plan provisions that call for lump sums in excess of the statutory minimum amount. PBGC audits also uncover failures to obtain appropriate elections and spousal consents, failures to include all benefit options in annuity contracts, and failures to provide benefits to certain “overlooked” participants. Clearly, special care is called for when completing a standard termination distribution, as the PBGC will carefully review the distribution upon audit.

INFORMATION PENALTIES

Special care is also called for when dealing with PBGC reporting and disclosure requirements, as the PBGC has the authority under ERISA §4071 to assess a penalty of up to \$1,100 *per day* for noncompliance.⁸² This penalty covers many diverse areas, including post-event reporting requirements under ERISA §4043(a), advance reporting requirements under ERISA §4043(b), missed contribution notification requirements (if the missed contributions, including interest, exceed \$1 million) under ERISA §302(f)(4), employer reporting requirements under ERISA §4010, and Participant Notice requirements under ERISA §4011.

In the premium area, the PBGC tends not to assess an information penalty if there is a late filing of premium information coupled with late payment of the required premium, because the penalty for the late premium payment is usually an adequate penalty.⁸³ In contrast, the PBGC may well assess a penalty for failure to provide premium-related information in a

timely manner in connection with a PBGC premium audit. In the standard termination area, the PBGC will on occasion nullify a standard termination for failure to file or issue a required notice in a timely manner. In such a case, the PBGC is unlikely also to assess an information penalty,⁸⁴ presumably because nullification is an adequate remedy and, perhaps more importantly, there is a good argument that the reporting or disclosure requirement has been retroactively eliminated by the nullification. On the other hand, failure to timely provide material information requested by the PBGC as part of a standard termination audit may lead to an information penalty,⁸⁵ as may failure to file a post-distribution certification (certifying that the standard termination distribution has been properly completed) by the 90th day after the distribution deadline.⁸⁶

Unlike penalties for late payment of premiums, which are mechanically assessed at rates specified in PBGC regulations,⁸⁷ information penalties entail discretion as to the amount, if any, to be assessed. Under its existing penalty policy, published in 1995,⁸⁸ the PBGC generally does not assess information penalties at the maximum daily rate of \$1,100. For most reporting or disclosure failures, the PBGC’s “guideline” penalty rates are \$25 per day for the first 90 days of delinquency and \$50 per day thereafter, subject to two adjustments that can help smaller plans. First, these daily rates are proportionately reduced in accordance with the number of participants (subject to a floor of \$5 per day) in the case of plans with fewer than 100 participants, so that (for example) the guideline penalty rate for a plan with 25 participants would be \$6.25 (25% of \$25) per day for the first 90 days and \$12.50 (25% of \$50) per day thereafter. Second, the total guideline penalty is capped at \$100 times the number of participants in the plan, so that (for example) the guideline penalty would not exceed \$2,500 for a 25-participant plan. These “guideline” amounts may be adjusted based on the facts and circumstances of the particular case.⁸⁹

The penalty rates can be much higher for failures involving certain notices of particular importance to the PBGC. Its 1995 policy calls for the PBGC generally to assess the full \$1,100 daily penalty for failure to provide an advance notice of a reportable event under ERISA §4043(a) or a notice of a missed contribution exceeding \$1 million under ERISA §302(f)(4), because “this information is so time sensitive and sig-

⁸¹ See Q&A-14 of the 2001 PBGC Blue Book.

⁸² ERISA §4071, 29 USC §1371; 29 CFR §§4071.1, .3. The \$1,000 daily rate set forth in ERISA §4071 was adjusted upward to \$1,100 to account for inflation pursuant to the Federal Civil Monetary Penalty Inflation Adjustment Act of 1990, as amended by the Debt Collection Improvement Act of 1996. See 62 Fed. Reg. 36993 (July 10, 1997).

⁸³ See proposed Appendix to 29 CFR Part 4071, §28(a) (66 Fed. Reg. 2856, 2864 (Jan. 12, 2001)).

⁸⁴ See *id.* at §28(b).

⁸⁵ 29 CFR §§4041.5(b), .6.

⁸⁶ 29 CFR §§4041.6, .29(b); see n. 76.

⁸⁷ See 29 CFR §4007.8.

⁸⁸ 60 Fed. Reg. 36837 (July 18, 1995).

⁸⁹ *Id.* at 36837–38.

nificant that a larger penalty is warranted.”⁹⁰ In addition, the PBGC may assess a penalty above the guideline level where there is a willful failure to comply, a pattern or practice of noncompliance, or substantial harm to participants or the PBGC resulting from a compliance failure.⁹¹

When facing a penalty assessment under ERISA §4071, it is helpful to review not only the PBGC’s 1995 existing penalty policy but also its 2001 proposed penalty policy.⁹² Even though the proposed policy has not yet been adopted, in practice, PBGC staff tend to use it as a guide.⁹³ The existing policy offers sparse guidance on the factors the PBGC is likely to consider in determining the penalty amount and whether to grant a partial or complete waiver. The proposed policy contains extensive guidance in both areas and, thus, can serve as a highly effective “road map” for the practitioner seeking to gather arguments in response to a penalty assessment.

The guidance on information penalty waivers in the 2001 proposed policy generally mirrors the guidance in that policy (discussed earlier in this article) on late premium payment penalty waivers. In particular, the proposed guidance essentially collapses the actions or omissions of the responsible person (generally the plan administrator) with those of the outside advisor (generally an enrolled actuary) in evaluating whether there was reasonable cause for a payment failure.⁹⁴ To persuade PBGC decision-makers, it is therefore helpful to go beyond establishing that the plan administrator exercised due diligence in selecting and monitoring the enrolled actuary and argue as well that there was reasonable cause for any actions or omissions of the enrolled actuary that contributed to the payment failure.

REPORTING AND DISCLOSURE REQUIREMENTS: TRAPS FOR THE UNWARY

Dealing with PBGC reporting and disclosure requirements can be challenging, in part because many of them apply only on a sporadic rather than a periodic basis. Typically, the hard part is not filing the report or making the disclosure but identifying the events and circumstances that may give rise to the requirement and determining whether it applies.

Reportable Events (ERISA §4043)

A reportable event is an event that *may* be indicative of a need to terminate a plan. The event may in-

volve the plan itself (e.g., inability to pay benefits when due) or a member of the controlled group maintaining the plan (e.g., bankruptcy of the contributing sponsor or of a member of its controlled group). Post-event reporting is the responsibility of both the plan administrator and the contributing sponsor of the plan for which the event occurs and is due within 30 days after the contributing sponsor or plan administrator knows or has reason to know that the event has occurred.⁹⁵ Advance reporting (which applies only to privately held controlled groups with significantly underfunded plans) is the responsibility of the plan’s contributing sponsor and is due 30 days before the event becomes effective.⁹⁶ The PBGC’s reportable events regulation provides for various reporting waivers and extensions, most of which are tied to particular events. When the PBGC is notified of a reportable event, it will decide whether to investigate further, take action, or simply close its file on the matter.

Because many reportable events will involve a member of the “plan’s controlled group,” it is important to understand the PBGC-specific definition of that term. A plan’s controlled group means each contributing sponsor of the plan and each member of each such contributing sponsor’s controlled group. In the case of a multiple-employer plan, this may include entities not affiliated with a particular contributing sponsor. In any case, this may include foreign entities. To ensure compliance with the PBGC’s reportable events rules, it is important to have a mechanism in place to track events involving all members of each plan’s controlled group.

Under the PBGC’s reportable events regulation, all reportable events occur with respect to a plan,⁹⁷ either directly or because the event involves an entity that is a member of the “plan’s controlled group.” In the latter situation, a particular event may occur with respect to two or more plans maintained by a single controlled group (e.g., if an entity that is undergoing a bankruptcy or liquidation is a member of the “plan’s controlled group” for two or more plans). In such a case, the filing obligation with respect to each plan is independent of the filing obligation with respect to each other plan.⁹⁸ Thus, if the reporting requirement is waived with respect to one or more, but not all, of those plans (e.g., where one plan, but not another, qualifies for a waiver based on its funding level), the contributing sponsor and (for post-event reporting) the plan administrator of each plan for which no waiver applies are required to report. A single filing

⁹⁰ *Id.* at 36838.

⁹¹ *Id.*

⁹² 66 Fed. Reg. 2856 (Jan. 12, 2001).

⁹³ *See* n. 70.

⁹⁴ 66 Fed. Reg. at 2865.

⁹⁵ ERISA §4043(a), 29 USC §1343(a); 29 CFR §4043.20.

⁹⁶ ERISA §4043(b)(3), 29 USC §1343(b)(3); 29 CFR §4043.61(a).

⁹⁷ *See* 29 CFR §§4043.20, .61.

⁹⁸ 29 CFR §4043.3(a)(2).

will suffice,⁹⁹ but absent such a filing, each person required to report is exposed to penalties.¹⁰⁰

A detailed review of each of the reportable events, and of their associated waivers and extensions, is beyond the scope of this article. However, some observations about certain of the events may prove helpful in minimizing the risk of inadvertent reporting failures.

- **Extraordinary dividend.** There is a statutory reportable event if the contributing sponsor or controlled group member declares an “extraordinary dividend” as defined at 26 USC §1059(c).¹⁰¹ The PBGC waived reporting of this statutory reportable event¹⁰² but created a regulatory reportable event for an “extraordinary dividend” using a different definition.¹⁰³ Under the PBGC’s definition, any transfer of value to a shareholder that exceeds certain thresholds is reportable, and a transfer to another member of the controlled group — up, down, or sideways — is treated as a transfer to a shareholder.¹⁰⁴ Thus, even an intra-controlled group sale for less than full value could result in a reporting obligation.¹⁰⁵
- **Change in contributing sponsor or controlled group.** Another reportable event is if there is “a transaction that results, or will result, in one or more persons ceasing to be members of the plan’s controlled group.”¹⁰⁶ The classic situation covered by this reportable event is a controlled group breakup, e.g., where a subsidiary is sold to another controlled group. However, this reportable event also covers a transfer of a plan to another controlled group without any change in the makeup of either controlled group.¹⁰⁷ This is because, from the perspective of the plan, *all* persons who were part of the plan’s controlled group will no longer be part of the plan’s controlled group once the transaction becomes effective. As for the timing of reporting, the

event is not the actual breakup of the controlled group or the actual transfer of plan sponsorship; it is, rather, the transaction as a result of which the controlled group *will* break up or the plan *will* be transferred. Thus, reporting is due 30 days after there is a legally binding agreement, even if there is a later closing or effective date.¹⁰⁸

- **Active participant reduction.** Reporting is required when there is a reduction in the number of a plan’s active participants to less than 80% of the number at the beginning of the current plan year or to less than 75% of the number at the beginning of the previous plan year.¹⁰⁹ This reportable event may occur on any day of the plan year, and the reduction need not be triggered by a discrete event such as a plant shutdown. Thus, even normal attrition may cause the plan to cross the 80% or 75% reporting threshold and thereby lead to a mid-year reporting obligation (subject to extensions tied to Form 5500 and premium filings).¹¹⁰

Annual Employer Financial and Actuarial Reporting (ERISA §4010)

Under ERISA §4010 and the PBGC’s implementing regulations, certain controlled groups are required to file annual reports with the PBGC containing specified financial and actuarial information.¹¹¹ The most common trigger for reporting is that the plans maintained by the controlled group have aggregate underfunding on a PBGC premium basis that exceeds \$50 million. Outstanding waivers or missed contributions exceeding \$1 million for any one plan maintained by the controlled group will also trigger the reporting obligation. Thus, depending on the funding levels of the various plans involved and on the status of any waivers or missed contributions, a particular controlled group may (for example) have to report one year, not have to report the next year, and then have to report again the following year.

The rules on whether a §4010 report is required and, if so, its contents are beyond the scope of this article. They are covered in some detail in PBGC regulations, with additional guidance in PBGC Technical Update 96-3, in various PBGC Blue Books, and on the PBGC’s website. There is one aspect of the PBGC’s rules, however, that bears not only men-

⁹⁹ 29 CFR §4043.3(a)(3).

¹⁰⁰ 29 CFR §4043.3(e).

¹⁰¹ ERISA §4043(c)(11), 29 USC §1343(c)(11).

¹⁰² 29 CFR §4043.31(c)(1).

¹⁰³ 29 CFR §4043.31(a).

¹⁰⁴ 29 CFR §4043.31(e)(3); Q&A-21 of the 1998 PBGC Blue Book.

¹⁰⁵ Q&A-22 of the 1998 PBGC Blue Book.

¹⁰⁶ 29 CFR §4043.29(a).

¹⁰⁷ See 29 CFR §4043.29(e)(2); Q&A-23 of the 1998 PBGC Blue Book.

¹⁰⁸ Q&A-24 of the 1998 PBGC Blue Book.

¹⁰⁹ 29 CFR §4043.23(a).

¹¹⁰ See 29 CFR §4043.23(d).

¹¹¹ ERISA §4010, 29 USC §1310; 29 CFR Part 4010.

tioning, but highlighting. Under a recent change that went into effect starting with the reports due (for calendar-year filers) on April 15, 2005,¹¹² a controlled group that was required to file a §4010 report for the previous year, but that is not required to file for the current year (e.g., because aggregate underfunding dropped from \$51 million to \$49 million), now is required to file a (partial) §4010 report for the current year just to demonstrate why it is not required to file a (complete) §4010 report for the current year.¹¹³ Although it is not clear that the PBGC would be able to assess an information penalty for failure to file such a (partial) §4010 report, there is little reason to become a test case and, therefore, much reason for current filers routinely to mark their calendars for the following year's §4010 deadline.

Participant Notice (ERISA §4011)

Plan administrators of certain underfunded plans are required by ERISA §4011 and the PBGC's implementing regulations¹¹⁴ to notify participants and beneficiaries annually of the plan's funding status and the limits of the PBGC's guarantee. Like the employer reporting requirement just discussed, the applicability of the Participant Notice requirement can change from year to year.

There has been some confusion as to how the Participant Notice is tied to the plan year for which it is issued. A Participant Notice "for" a plan year is issued "in" that plan year,¹¹⁵ just as the PBGC premium for a plan year is paid in that plan year. In contrast, the Summary Annual Report (SAR) for a plan year is issued in the *next* plan year, just as the Form 5500 for a plan year is filed in the next plan year. A Participant Notice is required for a plan for a particular plan year if a PBGC variable-rate premium is payable for that plan year, unless the plan meets a funding-related test (the "DRC Exception Test") for that plan year or for the preceding plan year.¹¹⁶ If it is required, its deadline tracks the deadline for the SAR for the previous plan year, i.e., two months after the deadline, or extended deadline, for the Form 5500 for the previous plan year.¹¹⁷

There has also been some confusion about how the Participant Notice requirements apply to small plans, i.e., those with 100 or fewer participants on an aggregated controlled group basis. When the PBGC first implemented the Participant Notice requirements, it

exempted small plans for the 1995 plan year.¹¹⁸ Apparently, the PBGC did a good job of publicizing the exemption; the author has heard a number of practitioners claim, in very recent years, that small plans are exempt from the Participant Notice requirements, even though the exemption disappeared starting with the 1996 plan year. The only special treatment that small plans qualify for today are a set of special rules they may use in calculating their "funded current liability percentage" for purposes of determining whether a Participant Notice is required and, if so, the percentage to include in the notice itself.¹¹⁹

Special care is called for in connection with the disclosure of missed contributions in a Participant Notice. Under ERISA §101(d), an employer that fails to make a required minimum funding contribution (including a required quarterly installment) by the 60th day following its due date must issue a notice of the failure to participants and beneficiaries "at such time and in such manner" as the Secretary of Labor may prescribe. Although there are no regulations prescribing the time and manner of issuance, DOL takes the position that such a notice must nonetheless be issued within a reasonable period of time after the failure.¹²⁰

A "safe harbor" of sorts may be available if the missed contribution is disclosed in a Participant Notice. In the preamble to its final rule implementing the Participant Notice requirements, the PBGC noted that DOL had advised it that, in the absence of final regulations implementing ERISA §101(d), disclosure of a missed contribution in a Participant Notice would be treated by DOL as satisfying the ERISA §101(d) requirements with respect to that missed contribution.¹²¹ Later guidance in the PBGC Blue Book makes clear that this approach may not work if a plan is not subject to the Participant Notice requirement for the first Participant Notice in which the missed contribution would have to be included and the plan administrator instead makes the disclosure for the first time in a Participant Notice for a later plan year.¹²² In such circumstances, it may be necessary to comply directly, rather than through the Participant Notice requirement, with the ERISA §101(d) requirement.

"Early Warning Program" Negotiations

The PBGC monitors corporate transactions through its "Early Warning Program" to determine when it

¹¹² 70 Fed. Reg. 11540, 11541-42, 11543 (Mar. 9, 2005).

¹¹³ 29 CFR §4010.6(a)(2).

¹¹⁴ 29 CFR Part 4011.

¹¹⁵ See 29 CFR §§4011.3, .8.

¹¹⁶ 29 CFR §4011.3.

¹¹⁷ 29 CFR §4011.8.

¹¹⁸ 29 CFR §4011.4(a); 60 Fed. Reg. 34412 (June 30, 1995).

¹¹⁹ 29 CFR §§4011.4(b), .10(c)(2).

¹²⁰ *Reporting and Disclosure Guide for Employee Benefit Plans*, U.S. Department of Labor, Employee Benefits Security Administration, at p. 6, available at <http://www.dol.gov/ebsa/pdf/rdguide.pdf>.

¹²¹ 60 Fed. Reg. 34411, 34412 (June 30, 1995).

¹²² Q&A-19 of the 1998 PBGC Blue Book.

needs to take action to protect the plan termination insurance program. The Early Warning Program, which is staffed by PBGC financial analysts, accountants, actuaries, and attorneys, is explained in some detail in PBGC Technical Update 00-3, which is available on the PBGC's website.

Key to an understanding of the Early Warning Program is the concept of joint and several liability. The PBGC, unlike most other creditors, has a direct claim against each member of the controlled group, not just against the contributing sponsor. Thus, the PBGC is concerned not only about the financial wherewithal of the controlled group generally, but also about where the pockets of value are. Changes in the ability of one or more controlled group members to satisfy all or part of a PBGC claim in the event of plan termination can have a significant effect on the PBGC's expected losses if a plan were to be terminated.

Also key to an understanding of the Early Warning Program is the PBGC's ability to terminate a plan involuntarily if it "determines that the possible long-run loss of the [PBGC] with respect to the plan may reasonably be expected to increase unreasonably if the plan is not terminated."¹²³ It is this authority that the PBGC primarily relies upon in attempting to persuade a company to provide additional protection to an underfunded plan in connection with a corporate transaction.

The PBGC has neither the resources nor the incentive to focus on transactions that are unlikely to pose an increased risk of significant long-run loss to the pension insurance program. In Technical Update 00-3, the PBGC stated that it may contact a company for further information about a corporate transaction only if: (1) the company has a below-investment-grade bond rating and sponsors a pension plan that has current liability in excess of \$25 million, or (2) the company (regardless of its bond rating) sponsors a pension plan that has current liability in excess of \$25 million and that plan has unfunded current liability in excess of \$5 million. In many cases, the PBGC has no need to contact a company about a particular transaction even if these screening criteria are met.

Transactions the PBGC is particularly concerned about are those that may substantially weaken the financial support for a pension plan, such as a breakup of a controlled group (e.g., through sale of a subsidiary); the transfer of a significantly underfunded plan (or of some of its liabilities) to another, perhaps weaker, controlled group (e.g., in connection with sale of a business); a leveraged buyout; a major divestiture by an employer that retains significantly underfunded pension liabilities; a payment of extraordinary divi-

dends; and a significant substitution of secured for unsecured debt. Among the protections the PBGC is likely to seek in these and similar circumstances are: (1) additional cash contributions to the plan (with an agreement to maintain a credit balance equal to the additional contributions for a period of time); (2) collateral or a letter of credit to secure payment of future contributions or of potential future plan termination liability (or of both); and (3) guarantees by financially stronger members that are leaving the controlled group either to assume the plan or to pay some or all of ongoing contribution obligations or of plan termination liability if the post-transaction controlled group ends up being unable to support the plan.

In most cases, the PBGC's leverage is its ability to pursue what many view as "the nuclear option," an involuntary termination that would result in the entire plan termination liability coming due immediately. In many cases, that option is not an attractive one for the PBGC, not only because it may not want to take the political and public relations blame for causing significant job losses, but also because it may be hesitant to lock in an immediate loss if plan termination is not otherwise inevitable. Whether the PBGC will make good on a threat to pursue an involuntary termination depends on the particular facts and circumstances. The parties to the transaction will have to make a judgment as to the price, if any, they should pay to gain the PBGC's agreement not to pursue the nuclear option. The key argument to make to the PBGC, aside from any arguments about the potential political and public relations consequences that would accompany an involuntary termination, is that there is no need to act now because the post-transaction controlled group *will* be able to maintain the plan without the need for any additional protection. Such an argument may require substantial support, both on financial issues (e.g., future cash flows) and on actuarial issues (e.g., future contribution requirements).

Another weapon the PBGC may have in its arsenal, depending on the nature of the transaction, is the ability to bring a pension evasion lawsuit under ERISA §4069 if the plan terminates within five years after the transaction becomes effective. Such a lawsuit, however, will likely involve years of litigation and an uncertain outcome. The parties to a transaction may want to request that the PBGC review a transaction in advance and commit that it will not bring such a lawsuit. The problem is that the PBGC may well insist on a hefty price for such a comfort letter, and the comfort may not be worth the price.

In some cases, particularly if it is highly likely that the PBGC will find out and have concerns about the transaction, it may be useful to contact the PBGC early on. If it is inevitable, or nearly so, that there will be PBGC involvement in a corporate transaction, such

¹²³ ERISA §4042(a)(4), 29 USC §1342(a)(4).

a preliminary contact may help prevent last-minute surprises.

DISTRESS AND INVOLUNTARY TERMINATIONS

An underfunded plan may be terminated only in a distress or involuntary termination. The distress criteria can be hard to meet, and the PBGC is unlikely to pursue an involuntary termination if it believes that the controlled group can afford to maintain the plan.

In a distress termination, each member of the controlled group must satisfy at least one (but not necessarily the same one) of four distress criteria: (1) liquidation in bankruptcy (or similar proceeding); (2) reorganization in bankruptcy (or similar proceeding); (3) inability to pay debts when due and continue in business; and (4) unreasonably burdensome pension costs solely as a result of declining employment.¹²⁴ The first two distress criteria, both involving bankruptcy (or similar proceedings), are by far the most common, with liquidation leading the pack. In a liquidation context, a distress finding is essentially automatic, provided each other member of the controlled group also meets distress. The more difficult and interesting cases are those involving reorganizations under distress criterion 2.

To qualify under distress criterion 2, the controlled group member must persuade the bankruptcy court (or other appropriate court) to “determine[] that, unless the plan is terminated, such person will be unable to pay all its debts pursuant to a plan of reorganization and will be unable to continue in business outside the reorganization process and approve[] the plan termination.”¹²⁵ The PBGC will typically enter an appearance in such proceedings and, at a minimum, impress upon the court its views as to the stringent requirements imposed by distress criterion 2. Depending on the circumstances, the PBGC may express no view, opposition, or (less likely) support on the merits of the distress showing.

A successful distress showing under criterion 2 will often require evidence that “meaningful sacrifices” were made in a variety of areas, not just for pensions.¹²⁶ Everything from executive compensation to capital expenditures to current rank-and-file wages and plant closings is potentially at issue. And if the reorganization hinges on the willingness of a lender or investor to put new money in, and the lender or investor is insisting that the pension plan be terminated, it

is important to do more than simply note that precondition.¹²⁷ There should be a showing both of a rational economic basis for the precondition and of an unsuccessful (ideally extensive) effort to find funding that would not require terminating the plan.

If there are two or more plans that a controlled group is seeking to terminate in a distress termination, the PBGC takes the position that distress criterion 2 must be met separately with respect to each plan, rather than being evaluated in the aggregate with respect to all plans maintained by the controlled group. The case law to date has not been supportive of the PBGC’s position,¹²⁸ but the PBGC is pursuing the issue on appeal. If you have such a case and can demonstrate distress both on an aggregate and on a plan-by-plan basis (e.g., where even the plan requiring the least funding going forward is clearly unaffordable), that would of course moot the issue.

The PBGC must terminate a plan involuntarily if the plan is currently unable to pay benefits when due, and it may do so in certain other circumstances, including cases in which the plan has not met the minimum funding standard under 26 USC §412, the plan will be unable to pay benefits when due, or (as discussed earlier in this article) “the possible long-run loss of the [PBGC] with respect to the plan may reasonably be expected to increase unreasonably if the plan is not terminated.”¹²⁹ Involuntary termination can be a useful tool for the PBGC to cut off impending shutdown benefits, to block a corporate transaction (e.g., sale of a subsidiary), or (far less controversially) to take over an abandoned plan. And in many cases, an “involuntary” termination serves as a low-cost alternative to a distress termination and is accomplished through a simple agreement between the PBGC and the plan administrator; such “consensual involuntary terminations” are far more common than contested involuntary terminations that are ultimately resolved in court.

Whichever method is used to accomplish the termination, if the plan is (as is typically the case) insufficient for guaranteed benefits, the PBGC will take the plan over as successor trustee. There is considerable hand-holding by PBGC staff throughout the transition, so that records, assets and (ideally) knowledge are efficiently passed from the former plan administrator to the PBGC.

¹²⁷ See, e.g., *In re Philip Services Corp.*, 310 B.R. 802 (Bankr. W.D. Mo. 2002).

¹²⁸ *In re Kaiser Aluminum Corp.*, 34 EBC 2228 (D. Del. 2005), appeal docketed, No. 05-2695 (3rd Cir. June 8, 2005); *In re Falcon Products, Inc.*, Case No. 05-41108-399 (Bankr. E.D. Mo. Oct. 26, 2005), appeal docketed, No. 4:05-cv-02247-CAS (U.S. Dist. Ct., E.D. Mo. Nov. 30, 2005).

¹²⁹ ERISA §4042(a), 29 USC §1342(a).

¹²⁴ ERISA §4041(c)(2)(B), 29 USC §1341(c)(2)(B); 29 CFR §4041.41(c).

¹²⁵ 29 CFR §4041.41(c)(2)(iv).

¹²⁶ See 133 Cong. Rec. H11970 (Dec. 21, 1987).

BANKRUPTCY

The PBGC is often one of the largest creditors, if not the largest, in a bankruptcy involving an underfunded plan covered by the PBGC's single-employer program. As such, it often serves as an active member of the creditors committee and plays a significant role in the bankruptcy.

The PBGC may be wearing either of two hats when it files a bankruptcy claim. As guarantor, it files claims for employer liability (representing underfunding upon plan termination) and for unpaid premiums; as statutory trustee (or as prospective statutory trustee), it files claims for unpaid contributions. (In appropriate cases, it may also file claims, as statutory trustee, for fiduciary breach.)

Where there are multiple plans and multiple debtors, there is a multiplicity of PBGC claims. The PBGC generally files its three claims — for employer liability, unpaid contributions, and unpaid premiums — for *each* plan with respect to *each* debtor to preserve its arguments that the claims should be satisfied on a joint and several basis. Thus, for example, if there are four plans maintained by a controlled group consisting of five debtors, one can expect 60 claims (three claims for each plan, times four plans for each debtor, times five debtors). A detailed discussion of the various priority arguments the PBGC makes in its claims, usually without much acclaim from the courts,¹³⁰ is beyond the scope of this article.

In most cases, the largest PBGC claim by far, which is often also the largest in the bankruptcy, is its employer liability claim,¹³¹ which represents the difference between the value of the plan's liabilities and the value of its assets. The PBGC calculates the value of the plan's liabilities by using a set of actuarial assumptions that are set forth in its valuation regulation and that are intended to produce a price in line with what an insurance company would charge to assume the plan's liabilities.¹³² One of these assumptions in particular — the interest assumption that is used to discount the future stream of benefits to a present value — has attracted a fair amount of controversy,

with two courts of appeals rejecting the PBGC's interest assumptions as being too low and therefore producing benefit values that are too high.¹³³ On the other hand, the PBGC was more recently able to persuade a bankruptcy judge in the US Airways case to “respectfully disagree[]” with those two appellate decisions and to uphold the use of the PBGC's interest assumptions.¹³⁴ In most cases, however, the allowed amount of the claim will be negotiated rather than litigated.

Settlements of the PBGC's bankruptcy claims are common, usually on a “global” basis without any attribution of particular dollars or even of particular priorities to particular claims. The analysis that goes into the settlement necessarily reflects the respective parties' views as to the likelihood that the PBGC would succeed in supporting its asserted claim amounts and priorities. (The settlement may also reflect the PBGC's recognition that it has significant leverage in those many cases in which litigation delay could precipitate disaster as a result of lost business, difficulty in obtaining financing, or the like.) It is important to have an actuary review the PBGC's claim amounts and underlying data and assumptions to determine whether the claim can properly be reduced. Once the actuaries get together to crunch the numbers, it is up to the lawyers to get together to debate the law surrounding such matters as which assumptions may properly be used in bankruptcy cases and the extent, if any, to which a particular claim is entitled to priority treatment. Not all cases will settle; if the PBGC believes there is a good test case to pursue, a settlement with the PBGC may not be feasible, as it tends to place a very high value on a potentially good precedent in the “right” circuit.

CONCLUSION

The PBGC is facing many challenges and can be expected to act aggressively to protect its interests. For employers maintaining PBGC-covered plans, many of whom are facing their own challenges, knowing what to expect from the PBGC and how best to respond can make a significant difference in the ultimate outcome when there is a PBGC-related dispute. Hopefully, this article will serve as a useful starting point for the research and analysis needed to evaluate how to deal with the PBGC in a variety of contexts.

¹³⁰ See, e.g., *Belfance v. PBGC (In re CSC Indus., Inc.)*, 232 F.3d 505 (6th Cir. 2000); *PBGC v. Skeen (In re Bayly Corp.)*, 163 F.3d 1205 (10th Cir. 1998); *In re CF&I Fabricators of Utah*, 150 F.3d 1293 (10th Cir. 1998); *In re Sunarhauserman*, 126 F.3d 811 (6th Cir. 1997); *LTV v. PBGC (In re Chateaugay Corp.)*, 115 B.R. 760 (Bankr. S.D.N.Y. 1990), *aff'd*, *LTV Corp. v. Dole (In re Chateaugay Corp.)*, 130 B.R. 690 (S.D.N.Y. 1991), *vacated per consent order*, 1993 U.S. Dist. LEXIS 21409 (S.D.N.Y. June 16, 1993).

¹³¹ ERISA §4062(a)(1), (b); 29 USC §1362(a)(1), (b).

¹³² 29 CFR Part 4044, Subpart B; 70 Fed. Reg. 72205, 72205–06 (Dec. 2, 2005).

¹³³ *In re CF&I Fabricators of Utah, Inc.*, 150 F.3d 1293 (10th Cir. 1998); *Belfance v. PBGC (In re CSC Indus., Inc.)*, 232 F.3d 505 (6th Cir. 2000).

¹³⁴ *In re US Airways Group, Inc.*, 303 B.R. 784, 792 (Bankr. D. Va. 2003).