PBGC Issues

Beware of PBGC "Downsizing Liability"!

A downsizing employer with a PBGC-covered pension plan may have to grapple with a PBGC demand to protect that plan in the event it terminates in a distress or involuntary termination within the next five years. The protection may take the form of a bond, an escrow, or—more likely—a negotiated alternative, such as an additional contribution to the plan.

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A little-known and, until recently, little-used provision of ERISA can have a big impact on a downsizing employer with an underfunded PBGC-covered pension plan.

Statutory and Regulatory Framework

ERISA Section 4062(e) allows the PBGC to seek protection for a plan in the case of certain cessations of operations:

- *Trigger.* This contingent liability is triggered where "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."
- *Amount.* Under the PBGC's regulations, the amount of the liability equals the plan's underfunding (measured on a conservative PBGC plan termination basis as if the plan had terminated immediately after the cessation of operations) times the percentage reduction in active participants. [PBGC Reg. § 4062.8(a)] For example, in the case of a plan that is underfunded by $200 million on a PBGC termination basis and that experiences a 25 percent reduction in active participants in connection with a Section 4062(e) event, the resulting liability amount is $50 million.
- *Form of Protection.* The employer could be required to escrow the liability amount ($50 million in our example), or to purchase a bond for up to 150 percent of the liability amount ($75 million), to protect the pension plan in the event it terminates in a distress or involuntary termination within the next five years. If it does, the escrowed funds or the bond proceeds are added to plan assets; if not, at the end of the five-year period, the escrowed funds are returned (without any interest) or the bond is canceled.

This statutory liability is not self-executing. Rather, the PBGC first must decide to pursue the liability and, barring voluntary compliance, very likely would have to initiate a court action to be able to enforce it.

Reporting and PBGC Monitoring

When a Section 4062(e) event occurs for a PBGC-covered plan, the plan administrator is required under ERISA Section 4063(a) to notify the PBGC within 60 days. In addition, a separate notice may be required before, at, or after the time of the Section 4063(a) notice for any reportable event that occurs in connection with the cessation, such as an "active participant reduction" reportable event. Failure to comply timely with any of these reporting requirements may lead to the assessment of penalties of up to $1,100 per day under ERISA Section 4071.

As a practical matter, however, the PBGC will likely find out about any potential Section 4062(e) event of significance through its "Early Warning" Program (also called its "Risk Mitigation" Program) well before the Section 4063(a) (or reportable event) notice is due. The PBGC routinely monitors corporate transactions and events through its Early Warning Program to determine when it needs to take action

to protect the pension plan termination insurance program. At least in the case of public companies, a significant Section 4062(e) event may be the subject of public disclosures early on.

PBGC Enforcement

Until mid-2006, the PBGC faced significant difficulties in pursuing Section 4062(e) liability because the liability formula in the statute was unworkable. However, in mid-2006, the PBGC issued a final rule establishing a calculation methodology that enables the PBGC to pursue the liability more aggressively. [71 Fed. Reg. 38419 (June 16, 2006)] To date, in large part because of the difficulties the PBGC faced before the 2006 rulemaking, there is virtually no case law regarding Section 4062(e), and precious little interpretive guidance from the PBGC itself.

There is considerable discretion on the part of the PBGC to decide not to pursue *any* liability notwithstanding that a Section 4062(e) event has occurred. Similarly, the PBGC has—and routinely exercises—the discretion to negotiate an alternative arrangement in lieu of pursuing this liability. Such an alternative arrangement could take various forms, including a requirement for additional contributions or the granting of a security interest—and not necessarily a first lien position—for future contributions or for some portion of the underfunding.

For example, in December 2007, the PBGC reached a $77.5 million agreement with Swedish-owned Electrolux Home Products, Inc., in connection with a March 2006 shutdown of Electrolux's plant in Greenville, Michigan. Under the agreement, Electrolux agreed to waive an existing $42.5 million pension plan credit balance that would otherwise have excused Electrolux from making further contributions up to that amount, and further agreed to make $35 million in additional contributions to the plan over the next five years. In its press release announcing the Electrolux deal, the PBGC's Interim Director (and now Director), Charles E.F. Millard, stated that "[t]he PBGC will continue to aggressively monitor business transactions that may jeopardize pension plans and arrange suitable protections," thereby signaling to downsizing employers that the PBGC takes Section 4062(e) events seriously.

Unresolved Interpretive Issues

There are many unresolved interpretive issues concerning whether a Section 4062(e) event has occurred and, if so, the amount of the resulting liability. Here is a brief sampling:

- *Applicability to "going concern" asset sales.* When a division is sold in a "going concern" asset sale where operations "cease" *with the seller* but continue *with the buyer*—and, as a result of this "cessation," more than 20 percent of a plan's active participants are "separated from employment" *with the seller* but continue in employment *with the buyer*—has a Section 4062(e) event occurred? Several early PBGC opinion letters concluded that there was no Section 4062(e) event in the context of the particular "going concern" asset sales presented for consideration. In more recent years, however, certain 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.
- *Applicability to stock sales.* Might the PBGC argue that a stock sale constitutes a Section 4062(e) event, relying on the ERISA Title IV definition of "employer" as referring not just to the subsidiary being sold but to the entire controlled group maintaining the pension plan before the sale?
- *"Facility in any location."* What is a "facility in any location" where there are two or more buildings near one another? Does it matter whether the same or related "operations" are conducted in each of the buildings? What if the buildings are geographically dispersed but the work performed in them constitutes a single integrated set of "operations"? Can there be two "facilities" within a single building?
- *"Operations."* Can the cessation of one "operation" trigger Section 4062(e) liability where one or more other (perhaps entirely unrelated) "operations" continue at the same facility? If so, what constitutes an "operation" that is sufficiently distinct from other "operations" at the same facility?
- *"Cessation."* Must the "cessation" of the operation (or of all operations) at the facility be a complete cessation, without regard to the completion of any work in progress?
- *Timing.* What is the date of a "cessation" when it occurs in stages or gradually over an extended period of time?
- *"Result of."* Can a cessation of operations at one facility "result" in the separation of an employee at another facility (*e.g.*, where the complete

cessation of operations at a manufacturing facility is the cause of one or more separations of employment at a different facility that serves as a warehouse for the manufacturing facility)? What about employees who separate for reasons not clearly tied to the cessation (including normal attrition)?

- *"Separation from employment."* How should it be determined whether and when an employee is to be treated as having been "separated" in the context of layoffs, recall rights, etc.?

The existence of these and other interpretive issues can lead to significant complications and delays when the PBGC attempts to enforce the Section 4062(e) liability, whether through court action or through a negotiated resolution.

Conclusion

When a downsizing employer evaluates its expected downsizing costs, it is important to include a reliable assessment of any possible Section 4062(e) liability. The task is not always easy, given the many interpretive issues that may arise and the substantial discretion the PBGC has in fashioning a negotiated resolution. However, the task must be done, as the liability—however satisfied—may well dwarf the other downsizing costs. With careful planning, this potential PBGC "downsizing liability" can in some cases be minimized or eliminated. ■