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PBGC's Claimed Global Reach: A Practical Guide for Navigating Through the Uncertainty

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This article focuses on PBGC's position that foreign affiliates of a US plan sponsor are liable for ERISA

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controlled group liabilities, and provides a practical perspective on the related issues.

With continued globalization, sponsors of Pension Benefit Guaranty Corporation (PBGC)-covered pension plans often have foreign affiliates, some of which may have substantial assets. If, as is often the case, these foreign affiliates are part of the plan sponsor's Employee Retirement Income Security Act of 1974 (ERISA) "controlled group" (generally, companies related to each other through 80 percent or more ownership), the foreign affiliates would, according to PBGC, be jointly and severally liable for minimum required contributions to the pension plan, PBGC premiums, and the plan's unfunded benefit liabilities upon termination. That said, however, PBGC faces significant legal and practical difficulties in attempting to collect these liabilities from foreign affiliates.

As we near the half-century mark from the time of ERISA's enactment, whether and, if so, under what circumstances a foreign affiliate of a US plan sponsor can be successfully pursued for a controlled group obligation remains unclear. The unsettled nature of the legal landscape can be an opportunity, as long as an effective PBGC strategy is developed to navigate through the uncertainty.

For the purposes of this article, all references to "a plan" refer to a qualified defined benefit retirement plan covered by Title IV of ERISA, and references to "affiliate" are to an entity that is part of the plan sponsor's ERISA controlled group.

Foreign Affiliates and PBGC's Early Warning Program

Since 1993, PBGC has monitored the financial health of certain employers who sponsor plans that the agency believes present significant exposure to its plan termination insurance program. Under this "Early Warning Program," PBGC focuses on controlled groups maintaining plans that, in the aggregate, have $50 million or more in underfunding determined on a PBGC plan termination basis or at least 5,000 participants. PBGC has particular concerns about transactions that may weaken the financial support for the plans.

Frequent targets of PBGC attention are:

- Transactions that change the composition of the controlled group;
- Major divestitures by an employer that retains significantly underfunded pension liabilities;
- Leveraged buyouts leaving the controlled group member(s) with a large amount of secured debt;
- Substitutions of secured debt for a significant amount of unsecured debt; and
- Payments of very large dividends to shareholders.

Apart from the Early Warning Program, ERISA and PBGC's regulations require that many, but not all, transactions of potential concern be reported to PBGC, including in some situations where the report must be filed before the transaction becomes effective. If PBGC concludes that the closing of a proposed transaction would significantly increase its risk of loss, the agency generally will attempt to negotiate protections for the plan.

PBGC concerns about particular transactions and its resulting intervention often are expected in relation to a transaction involving a plan sponsor's domestic affiliates. But when a transaction involves foreign affiliates, PBGC's intervention may come as an unpleasant surprise.

For example, if the common parent of a controlled group that includes a plan sponsor seeks to sell the stock of a foreign affiliate, PBGC may assert that the affiliate's exit from the controlled group would substantially weaken financial support for the plan, and therefore request protections for the plan. PBGC does not have the authority to compel such protections. That being said, PBGC may have significant leverage based on its authority to initiate and pursue plan termination in various circumstances, including where PBGC determines that its possible long-run loss "may reasonably be expected to increase unreasonably if the plan is not terminated." [ERISA Section 4042(a)(4)]

Thus, PBGC has the authority to initiate plan termination proceedings before a transaction closes, seeking a pre-transaction termination date. Absent an agreement with a plan's administrator, the plan may only be terminated, and a date of plan termination established, by a federal court.

If the court issues a final order terminating the plan and establishes a pre-transaction termination date, all members of the plan sponsor's controlled group (including, according to PBGC, any foreign affiliates) as of that date would be jointly and severally liable for (among other things) the plan's unfunded benefit liabilities. Thus, the stage would be set for PBGC, even after the transaction becomes effective and the foreign

affiliate has left the controlled group, to pursue that affiliate for ERISA liabilities.

PBGC's initiation of termination proceedings has significant consequences for controlled group members, foreign and domestic. The mere possibility that PBGC may have statutory claims in the future can be enough to disrupt business transactions such as stock or asset sales, mergers, or acquisitions. That said, if the plan has not yet terminated, PBGC generally is receptive to negotiations regarding alternatives to termination and resolution of any ERISA funding liens. If additional protections for the plan and PBGC can be agreed on, the termination case can essentially be mooted.

PBGC's leverage to obtain protections increases to the extent that the agency has a credible case that it could successfully litigate its termination case. But PBGC may pursue protections even in cases in which its legal leverage is not strong (and in which, therefore, it is unlikely to initiate court proceedings seeking termination). In the above example, unless there are indications that the domestic controlled group will be unable to maintain and fund the plan *because of* the foreign affiliate's anticipated exit from the controlled group, a PBGC termination case based on that affiliate's exit is unlikely to succeed.

On the other hand, even if PBGC's prospects for success are slim, the buyers of the foreign affiliate may want certainty that no pension liabilities will follow the affiliate post-sale. In negotiating an appropriate resolution that provides that certainty and thus enables the transaction to proceed, the employer needs to evaluate the strengths and weaknesses of PBGC's position carefully and respond to PBGC's concerns proportionately.

As noted above, even in cases where PBGC has a strong basis for asserting that a plan should be terminated, PBGC generally is receptive to negotiations regarding protections that would reduce PBGC's risk of loss. Negotiated protections that address PBGC concerns may take various forms, including the waiver of an existing prefunding balance for the plan, additional contributions coupled with a prohibition on using the additional amount to create or increase the plan's prefunding balance, the granting of a security interest (not necessarily a first position) to the plan or to PBGC, a letter of credit, or a contractual guarantee by a party to the transaction that otherwise would not be liable for the plan post-transaction. These elements may be combined, for example, through a contractual guarantee coupled with additional contributions.

As discussed in more detail below, there may be insurmountable legal obstacles to PBGC's ability to collect termination liability from a foreign affiliate. As a result, PBGC may accept a resolution with respect to a foreign affiliate that it would be unlikely to accept with respect to a domestic affiliate.

For example, PBGC may conclude that a contractual arrangement involving a foreign affiliate has significant incremental value even if the affiliate arguably already has statutory liability, and even if the arrangement provides protection for only a small portion of what the termination liability would be if realized. Such contractual arrangements could include a guarantee by the foreign affiliate, a security interest in the stock or assets of the foreign affiliate, or an agreement to consent to PBGC's assertion of sufficient contacts for jurisdiction and venue in the event of litigation.

These same arrangements also may assist in resolving an employer's liability under ERISA Section 4062(e) with respect to a covered "cessation of operations" (which can occur in the context of stock or asset sales).

Foreign Affiliates and Plan Termination

An employer facing unaffordable pension costs may attempt to save its business by seeking to end its plan in a "distress termination." To qualify, the plan sponsor *and each controlled group member* must meet at least one of four statutory financial distress tests relating to liquidation, reorganization, inability to continue in business, or unreasonably burdensome pension costs.

The existence of a foreign controlled group member makes the distress process more complex. PBGC rules require the submission of detailed financial information regarding each controlled group member, whether domestic or foreign. Foreign affiliates understandably may be reluctant to provide financial information to PBGC, but without it, PBGC will not approve a distress termination. PBGC also will not approve a distress termination under the "business continuation test" if it has the necessary financial information about the foreign affiliates and concludes that, taking into account their financial circumstances, the controlled group as a whole can afford to maintain the plan.

However, if the foreign affiliates that are not in distress are unwilling to fund the plan, and the domestic members are in distress, PBGC may itself initiate plan termination proceedings even if the distress tests are not met. PBGC may do so if it determines that "the plan will be unable to pay benefits when

due"—regardless of the pendency of a distress termination filing. In the above example where the foreign affiliates are unwilling to fund the plan, PBGC may initiate termination proceedings based on such a determination.

It is worth noting that, although PBGC-initiated terminations often are referred to as "involuntary terminations," that term is a misnomer; in the majority of PBGC-initiated termination cases, the plan administrator (at the behest of the plan sponsor) consents to the termination. That would be the likely resolution of a PBGC-initiated termination when a distress termination filing is pending.

However, disputes do occur, particularly if PBGC initiates termination in an Early Warning Case on the grounds that the agency's possible long-run loss "may reasonably be expected to increase unreasonably if the plan is not terminated." See the discussion above.

If plan termination is necessary, PBGC may be receptive to early negotiation and resolution of termination and related liability issues where, for example, the reorganization of the sponsor and thus the jobs of its workforce are hanging in the balance.

In any event, whether termination was welcomed or opposed, once the plan is terminated, if ERISA liens and claims have not already been resolved, such resolution should be a priority.

Impact of ERISA Liens and Claims on Foreign Affiliates

ERISA provides for two different types of liens that may come into play in the situations addressed in this article. One pertains to ongoing plans and the other to terminated plans; both are enforceable by PBGC and generally are subject to the same rules, contained in Code Section 6323, that apply to federal tax liens. Both types of liens cover all property and rights to property belonging to each member of the controlled group.

The first type of lien arises under Section 303 of ERISA and Section 430(k) of the Code "in favor of the plan" when unpaid statutory minimum required contributions (including interest) exceed $1 million. If the possibility of such a lien has not been anticipated and addressed, the existence of the lien on either the assets or stock of a foreign affiliate could delay or disrupt significant corporate transactions.

The second type of lien arises under Section 4068 of ERISA, and it secures a portion of the liability to PBGC that arises upon plan termination. The Section 4068 lien amount is the lesser of (a) the unfunded benefit liabilities under the plan (measured on a conservative PBGC plan termination basis), or (b) 30 percent of the controlled group's net worth (as determined by PBGC). The controlled group's net worth consists of the sum of the net worth of each person in the controlled group that has a net worth greater than zero, with net worth generally determined as of the plan termination date. This includes, according to PBGC, the positive net worth of foreign affiliates. Notably, where domestic controlled group members have little or no positive net worth, a Section 4068 lien could be based largely or entirely on a PBGC determination that one or more foreign affiliates have positive net worth.

It is important to be aware that Section 4068 liens arguably arise retroactively, and thus the existence or potential future existence of a Section 4068 lien can present thorny practical questions. ERISA states that the lien "arises on the date of termination of a plan." But whether there is a lien and, if so, its amount, will not be known until sometime after plan termination.

More specifically, ERISA provides that the lien is triggered when PBGC makes a demand for payment of the plan's unfunded benefit liabilities and there is a neglect or refusal to pay. Those events cannot occur until a plan termination date has been established, and could occur months or even years thereafter. If and when they do occur, the lien arguably arises retroactively as of the termination date. If important corporate transactions are planned during this period of uncertainty, Section 4068 issues should be anticipated and contingency plans made.

Because both of these PBGC liens—the lien for missed contributions and the ERISA Section 4068 lien—are treated for certain purposes in the same manner as tax liens, these liens can "prime" (get ahead of) a creditor that had a perfected security interest at the time PBGC perfected its lien with respect to property that comes into existence thereafter, *e.g.*, inventory and receivables. Essentially, the security interests in such after-acquired property arise at the same instant, and a tie goes to the government (*i.e.*, PBGC's interest wins out because the lien is treated like a tax lien).

PBGC generally will take steps to perfect a lien against a foreign affiliate by filing the lien with the District of Columbia Recorder of Deeds in accordance with the rules relating to perfection of tax liens. This would, however, apply only to assets of the foreign affiliate located in the United States. To the extent the foreign affiliate has and/or expects in the future to do business in the United States or otherwise have US

assets, such a lien filing may induce the foreign affiliate to negotiate a resolution with PBGC that includes releasing the lien.

Whether or not there are ERISA liens, PBGC's termination claims are likely to be significant. When a plan terminates, PBGC's claims generally include those for the amount of the plan's unfunded benefit liabilities (measured on a conservative PBGC basis); for unpaid minimum funding contributions owed the plan; for unpaid annual PBGC premiums and related penalty and interest charges; and for a sizeable "termination premium" of $1,250 per participant, per year, for three years following plan termination.

PBGC'S Pursuit of Judgments Against Foreign Affiliates

Federal legislation is presumed to apply only within the territorial jurisdiction of the United States unless Congress explicitly provides for extraterritorial application. As a number of courts have found, there is no such language in ERISA. Thus, foreign affiliates may argue that ERISA has no extraterritorial application and therefore cannot impose liability on them.

PBGC, however, takes an expansive view of ERISA's global reach. In PBGC Opinion Letter 97-1, the agency concludes that the UK subsidiaries of a domestic parent company are jointly and severally liable under ERISA. PBGC first asserts that extraterritoriality issues are not implicated because the events that triggered the foreign affiliates' ERISA liability took place within US borders, and because under ERISA all controlled group members are treated as a single employer. PBGC then goes on to say that, in its view, "controlled group liability under ERISA was intended to have extraterritorial application."

PBGC's expansive view of the law is not surprising, but given the absence of clear legal authority, as well as the infrequency with which PBGC litigates claims against foreign affiliates, it is safe to say that the agency itself recognizes that its prospects for successfully collecting ERISA liabilities from foreign affiliates, whether in US or foreign courts, are limited.

Pursuing Judgments in US Courts

To pursue a foreign affiliate in a US court, PBGC must establish that the US court has "personal jurisdiction" over the foreign affiliate. This will depend on the nature and extent of the affiliate's contacts with the United States and on whether any of its assets are in the United States. The mere fact that a foreign affiliate has common ownership with a domestic plan sponsor is an insufficient basis under the Constitution for a US court to exercise personal jurisdiction over the company. On the other hand, if the foreign affiliate actively engages in business in the United States, was involved in decisions with respect to the pension plan, or can be considered an alter ego of the plan sponsor, a US court may find that it has personal jurisdiction over the affiliate. In at least one reported case, hiring a US-based consultant to conduct due diligence on a US plan, communicating with that consultant and taking the consultant's findings into account in pricing a transaction was enough to find sufficient contacts with the United States to assert personal jurisdiction. [*PBGC v. Asahi Tec Corporation*, 979 F. Supp. 2d 46 (D.D.C. 2013)]

Even if PBGC were to succeed in obtaining a US judgment against a foreign affiliate, because of the difficulties PBGC faces in foreign courts, its ability to collect on the judgment may well be limited to any assets located within US borders.

Pursuing Judgments in Foreign Courts

PBGC's ability to collect statutory liabilities from foreign affiliates in foreign courts is even more problematic.

The fundamental issue for a foreign court to resolve is whether the foreign affiliate may be held liable for the pension-related liabilities of a US affiliate. Under US law, the issue is one of extraterritorial application of ERISA—an unsettled legal issue. A foreign court may well decide to apply the law of its own jurisdiction rather than US law to resolve this unsettled legal issue.

In *Walter Energy Canada Holdings, Inc. (Re)* [2017 BCSC 709 (May 1, 2017)], a Canadian court faced a claim by a US multiemployer plan against corporations that were incorporated in British Columbia or Alberta for controlled group pension-related liabilities of a US company. (Although this case involved a "multiemployer" pension plan pursuing controlled group liability, rather than PBGC seeking controlled group liability relating to a "single-employer" plan, the legal issues relating to extraterritoriality are essentially the same in both contexts.) There, the Canadian court first addressed choice of law, that is, whether Canadian law or US law would apply, and concluded that Canadian law would apply because, under choice of law principles, the issue was one of "separate legal existence or personality" and therefore should be governed by the place of incorporation. Then, applying Canadian law, the court rejected the

notion of controlled group liability as unsupported by Canadian law.

Principles of international comity provide for the recognition a nation shows to the legislative, executive or judicial acts of another nation. But a foreign court may rely on one of the following exceptions in concluding that comity principles are inapplicable with respect to the application of ERISA controlled group liability to the foreign affiliate, or as the basis for declining to enforce a US judgment imposing liability against the foreign affiliate.

- *The Revenue Rule*—An exception that may bar the collection of amounts that may be characterized as taxes or levies imposed by another jurisdiction. As noted earlier, ERISA provides that both Section 430(k) liens and Section 4068 liens are subject to the same rules that apply to federal tax liens, and PBGC routinely argues in bankruptcy cases that its claims should be treated as tax claims (and thus entitled to priority).
- *The Public Policy Rule*—An exception that may bar the collection of amounts where the liability is founded on a law that is contrary to public policy of the foreign affiliate's home jurisdiction. If the foreign affiliate's home jurisdiction, like the vast majority of non-US jurisdictions, respects corporate separateness, the foreign court may conclude that ERISA controlled group liability would be contrary to a public policy concern of that nation.
- *The Public Law Rule*—An exception that may bar the collection of amounts in a foreign jurisdiction if the collection serves a "public" or "penal" purpose. Given PBGC's status as a wholly-owned US government corporation and the fact that its claims serve to help finance PBGC's pension insurance program for US pensioners, the foreign court may conclude that some or all of PBGC's claims serve a public or penal purpose and thus would give rise to a significant public law concern.

Further, there may be treaties, tax or otherwise, between the US and the foreign jurisdiction that may bar the courts in that jurisdiction from enforcing collection of the amounts PBGC is seeking.

Despite these significant barriers, PBGC undoubtedly will continue to assert its statutory claims against foreign affiliates, both in negotiations and (albeit less frequently) in the courts.

Conclusion

Whenever a controlled group includes foreign affiliates, it is important to anticipate potential ERISA consequences flowing from significant business transactions and to develop an effective PBGC strategy to navigate through the uncertain legal waters. ■

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