

Dealing with PBGC Downsizing Liability

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Dealing with PBGC Downsizing Liability: Statutory Language

One sentence, many questions:

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

Dealing with PBGC Downsizing Liability: Stepped-Up Enforcement

- *1974–2006*: Section 4062(e) “on the books” but largely dormant
- *Mid–2006*:
 - PBGC adopts regulatory “fix” to liability formula
 - Sets stage for PBGC enforcement
- *2014*: PBGC statement at ABA Tax Section 2014 Midyear Meeting:

“Since 2007, PBGC has settled over 130 cases totaling 4062(e) liability of about \$1.7 billion, providing protection for almost 180,000 pension plan participants.”

Dealing with PBGC Downsizing Liability: The Basics

- Trigger requires *both*:
 - “Cessation” of “operations” (PBGC position: “an operation”) at a “facility in any location,” *and*
 - As “result” of cessation, more than 20% of active participants in a plan are “separated from employment”
- Thus, *no* 4062(e) liability where:
 - Total cessation, but results in no more than 20% active participant reduction percentage in any one plan
 - Large workforce reduction, but no cessation
 - Even if 100% of actives in one plan are separated!
 - Even if (*e.g.*) 75% of entire workforce is separated!

Dealing with PBGC Downsizing Liability: The Basics (Cont.)

- But 4062(e) liability *is* triggered if cessation *and* if resulting headcount reduction, even where:
 - Headcount reduction (e.g., 25% of actives in one plan) represents only (e.g.) 1% of employer's workforce!
 - Benefit liabilities attributable to the separated actives represent only (e.g.) 1% of the plan's benefit liabilities!
 - "Operations" that cease are de minimis in relation to employer's overall operations!
 - Cessation of operations clearly serves to strengthen the employer and its ability to fund pension plan!

Dealing with PBGC Downsizing Liability: The Basics (Cont.)

- Liability amount
 - Step 1: calculate unfunded benefit liabilities (full plan)
 - Use conservative PBGC assumptions
 - Determine immediately *after* cessation date (include shutdown benefits)
 - Step 2: multiply by active participant reduction percentage
 - Example
 - Unfunded benefit liabilities (full plan) = \$400M
 - Active participant reduction percentage = 25%
 - 4062(e) liability amount = \$100M

Dealing with PBGC Downsizing Liability: The Basics (Cont.)

- Satisfy liability with escrow or “up to 150%” bond
 - If distress or PBGC-initiated termination within five years:
 - Escrowed funds or bond proceeds added to plan assets
 - Subject to limits
 - Otherwise:
 - Escrowed funds returned (*without* interest)
 - Bond cancelled

Dealing with PBGC Downsizing Liability: Reporting

- Section 4063(a) notice due within 60 days
 - No exemptions based on plan size, funding, etc.
 - All reportable event waivers/extensions inapplicable
- Section 4043 reportable event notice may also be required
 - Often triggered by related active participant reduction
 - Due within 30 days after (*e.g.*) active participant reduction
 - Various waivers and/or extensions may be available
- *Either* notice may come due first
- Can combine notices in one filing
- PBGC often learns of 4062(e) events through media reports, 8-K filings, etc.

Dealing with PBGC Downsizing Liability: Open Issues

- Unresolved interpretive issues abound:
 - Applicability to asset or stock sales
 - “Facility in any location”
 - “Cessation” of “Operation(s)”
 - “Separated from employment”
 - “Result of”
- PBGC proposed rule (8/10/10) provided guidance on applicability/enforcement of 4062(e)

Dealing with PBGC Downsizing Liability: Open Issues (Cont.)

- Proposal adopted expansive views on applicability by treating liability as arising even where:
 - “Cessation”/“separation” occurs only with/from *seller* in asset (or possibly stock) sale
 - Only one of two or more “operations” cease
 - The “operation” is simply moved to another “facility”
 - The “operation” is later resumed at same facility (unclear)
 - The “operation” is replaced with another “operation”
- Public comments urged PBGC to reconsider proposal

Dealing with PBGC Downsizing Liability: Open Issues (Cont.)

- PBGC will re-propose rule (last stated target: March 2014)
- Extent to which “re-proposal” will result in significant changes from proposal is unclear
- Proposed rule does not control pending negotiations
 - Proposal not in effect (but generally reflects PBGC’s interpretation of statute)
 - Could change in re-proposal and/or in final rule
 - Even final rule interpretations could be challenged
 - Resolution likely to be through PBGC settlement
- Trade groups’ 12/16/11 letter asked PBGC to suspend enforcement actions based on positions in proposal

Dealing with PBGC Downsizing Liability: Legislative Proposals

- Neal bill (H.R. 2117, Section 404) would limit 4062(e)
 - Introduced on 5/22/13
 - Referred to various House Committees (including Ways/Means & Ed./Workforce)
- All operations at facility would have to cease, *and*
 - Cessation reasonably expected to be permanent
 - No portion of operations moved to other facility at different location or assumed/otherwise transferred to other employer
 - No other operations reasonably expected to be maintained at facility
- Headcount reduction based on full controlled group (not just plan) with terminations reasonably expected to be permanent
- All but headcount reduction change would apply to pending cases

Dealing with PBGC Downsizing Liability: Legislative Proposals (Cont.)

- Harkin bill (S. 1979, Section 303) would impose a two-year moratorium on 4062(e) enforcement
 - Introduced on 1/30/14
 - Referred to Senate HELP Committee
- Would prohibit PBGC from “bring[ing] any new action against a plan sponsor to enforce [4062(e)]” before 1/30/16
- Would require GAO to “study the effectiveness, fairness, and utility of [4062(e)]” and issue report by 1/30/15
- GAO report would include “recommendations for alternative ways to protect retirees and [PBGC] from cessations of operations while encouraging employers to both continue to offer defined benefit pension plans and to restructure as may be necessary to ensure the ongoing viability of the business”

Dealing with PBGC Downsizing Liability: Pilot Program

- PBGC announced 4062(e) enforcement pilot program on 11/2/12 (www.pbgc.gov/news/press/releases/pr12-32.html)
- PBGC generally will not enforce the 4062(e) liability:
 - Where company is “creditworthy” or “financially strong” and no “other indicators of financial weakness” or “other risks”
 - Where plan is small (flat-rate premium count is under 100)
- If company no longer creditworthy during five-year enforcement period, PBGC will enforce the 4062(e) liability
- No relief from reporting

Dealing with 4062(e) Downsizing Liability: Pilot Program (Cont.)

Financial soundness test:

- If company has unsecured debt equivalent ratings from both Moody's *and* S&P, needs Baa3 (Moody's) *and* BBB- (S&P)
- If company has unsecured debt equivalent rating from only one of these agencies, the rating just noted will suffice
- If no unsecured debt equivalent rating from either agency:
 - Must have D&B Financial Stress Score of at least 1477
 - Can't have secured debt (disregarding debt incurred to purchase real estate or equipment) >10% of its asset value

Dealing with 4062(e) Downsizing Liability: Pilot Program (Cont.)

Financial soundness test (cont.):

- But even if company meets one of above tests, it is *not* financially sound if there are “signs of financial weakness”
- “Signs of financial weakness” to be determined by PBGC
- “Signs of financial weakness” examples:
 - Lack of ongoing operations
 - Existing or imminent changes in business fundamentals such as a large drop in demand
 - Existing or imminent transactions that would result in a credit ratings downgrade
 - Insignificant amount of assets or operations in the U.S.

Dealing with PBGC Downsizing Liability: Negotiations

- Statutory liability
 - *Not* self-executing
 - Serves as starting point for negotiations
- PBGC tends to be flexible on *how* to satisfy liability, but not on *amount* (per PBGC determination) of liability
- But PBGC will adjust amount based on new information, additional information, etc. (do your due diligence!)

Dealing with PBGC Downsizing Liability: Negotiations (Cont.)

UBL estimate

- PBGC estimate generally based on roll-forward rather than updated census data
- Conversion from funding valuation basis to PBGC plan termination basis involves complex actuarial adjustments
- Many PBGC “shortcuts” can be challenged
- Always check with your actuary!

Active headcount reduction estimate

- Don't mechanically use last “1/1” or “12/31” count as denominator
- Consider carefully which separated individuals should be excluded from numerator based on “result of” test
- Consider using proposed rule guidance as basis for percentage

Dealing with PBGC Downsizing Liability: Negotiations (Cont.)

- PBGC can be creative in structuring settlement
 - Unlike “typical” Federal agency
 - Like private corporation vis-à-vis settlement flexibility
 - “Early Warning Program” deals are analogous (same goal: protect PBGC/plan in case plan terminates)
- Consider approaching PBGC in advance of possible downsizing

Dealing with PBGC Downsizing Liability: Negotiations (Cont.)

- Negotiating leverage for PBGC
 - Ability to assert 4062(e) liability, file 4062(e) lawsuit, or threaten lien filings without lawsuit
 - Effect of assertion, lawsuit, or lien filings on:
 - Existing loan/other agreements
 - Pending/future transactions (e.g., representations, warranties)
 - SEC disclosures
 - Financial statements
 - Credit ratings
 - Current or prospective lenders, investors, customers, and suppliers

Dealing with PBGC Downsizing Liability: Negotiations (Cont.)

- Negotiating leverage for employer
 - Unresolved interpretive issues
 - Greater risk for PBGC of unfavorable court precedent before any PBGC final rule is in place
 - Dispute whether 4062(e) event occurred
 - Dispute liability amount
 - Little/no risk of plan termination within 5 years
 - Downsizing will make employer stronger
 - 4062(e) liability would increase failure risk
 - Preserve jobs

Dealing with PBGC Downsizing Liability: Negotiations (Cont.)

- Settlement possibilities (may be “mix and match”)
 - Waiver of existing carryover or prefunding balance
 - Additional contributions
 - Commitment not to create or increase prefunding balance
 - May be over period of several years (5 years common)
 - Will reduce funding shortfall and, therefore, future minimum required contributions
 - PBGC may insist on security for additional contributions or, if security is not available, front-loading of contributions
 - Work in “caps” (e.g., standard termination sufficiency)
 - Evaluate likely effect of settlement options by asking your actuary to run scenarios (baseline, optimistic, pessimistic)

Dealing with PBGC Downsizing Liability: Negotiations (Cont.)

- Settlement possibilities (cont.)
 - Security for plan and/or PBGC
 - May cover future employer liability and/or future contribution obligations
 - Need not be 1st lien (depends on available value)
 - Could be letter of credit or escrow *with* interest
 - Controlled group stock generally not helpful to PBGC (given joint/several liability)
 - But stock of foreign controlled group member may be helpful to PBGC (legal/jurisdiction/collection problems in directly pursuing foreign entity under statute)
 - Guarantee by foreign controlled group member

Dealing with PBGC Downsizing Liability: Enforcement

- PBGC options for enforcement of 4062(e) liability
 - Issue administrative determination (with or without administrative appeal right!)
 - File enforcement action in U.S. District Court
 - Collect through tax refund offset or administrative offset?
 - Examples: IRS tax refund, DOD contractor payment
 - Significant legal issues as to applicability of offset
 - File notice of lien based on ERISA Section 4068 in lieu of (or in addition to) filing enforcement action!
 - PBGC takes position that 4068 lien, which by statute arises on plan termination date, may apply where plan is ongoing!
 - Significant legal issues as to applicability of lien to 4062(e)!

Questions?

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