



# AMERICAN BENEFITS COUNCIL

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## SUMMARY OF ERISA SECTION 4062(E) REFORMS

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On December 16, 2014, President Obama signed into law H.R. 83, the Consolidated and Further Continuing Appropriations Act, 2015 (Public Law 113-235) (the “Act”). Section 1 of Division P of the Act significantly reforms ERISA Section 4062(e). These reforms address in a very helpful way a problem attributable to the Pension Benefit Guaranty Corporation’s (“PBGC”) aggressive enforcement actions under Section 4062(e).

Very generally, the modifications (1) ensure that there is no 4062(e) event unless there is a substantial shutdown of operations at a facility relative to the size of the entire employer, (2) subject to certain exceptions, ensure that there is no 4062(e) event unless employees lose their jobs, as opposed to going to work for another employer, and (3) significantly reduce the scope of an employer’s liability if there is a 4062(e) event. The new rules generally apply to prior transactions, as well as future transactions.

Set forth below are (1) a description of the problems raised by Section 4062(e) prior to the Act, and (2) a discussion of the Act’s provisions. Appended to this summary is a copy of a statement by Senator Tom Harkin (D-IA) (“Harkin Statement”) in connection with Senate passage of a bill (S. 2511) containing the same legislative language. Senator Harkin was the original sponsor of the bill along with Senator Lamar Alexander (R-TN).

### BACKGROUND

Under the pre-Act 4062(e) statutory provision, liability to the PBGC could be triggered if “an employer ceases operations at a facility in any location.” The statute was clearly intended to apply to situations where operations at a facility are actually shut down, and for many years, that was how PBGC enforced the law. More recently, PBGC has taken the position that liability can be triggered where *no* operations are shut

down, but rather operations are, for example, (1) sold to another employer, (2) moved to another location, or (3) temporarily suspended for a few weeks to repair or improve a facility.

Moreover, under the PBGC's recent pre-Act approach, the liability for employers could be vastly out of proportion to the transactions that give rise to the liability. The liability amount was determined based on the product of (1) the percentage of employees who are participants in a defined benefit plan who separate from employment by reason of the cessation of operations, multiplied by (2) the plan's unfunded "termination liability" as calculated by PBGC, which is far greater than funding liability. For employers that have a plan that has been closed or frozen for many years, the number of employees who are participants in a plan can be a very small percentage of the total workforce. If more than 20 percent of that small number of employees happened to be involved in a minor business transaction, such as the sale of a small business unit, the liability could have been enormous. For example, a *de minimis* routine business transaction affecting far less than 1 percent of an employer's employees could have triggered hundreds of millions of dollars of liability, even in situations where a plan poses no meaningful risk to the PBGC.

Technically, Section 4062(e) required that employers post security with the PBGC at least equal to the liability amount, in case the plan terminates in an underfunded status. But to our knowledge, such security was very rarely provided. Instead, PBGC generally negotiated with employers to increase funding of the pension plans by the large and disproportional amounts that would otherwise be required as security. By diverting assets away from the business, this had very adverse effects on companies, business recovery, and jobs. This also harmed plan participants by driving employers out of the pension system. Finally, it was an end run around the funding rules that were adopted by Congress in the Pension Protection Act of 2006.

Under PBGC's enforcement approach, "creditworthy" companies and small plans were exempted. (Aside from the substantive points noted below, it was disturbing that PBGC reserved the right to override commercial standards of creditworthiness and apply its own test of creditworthiness.) These exemptions did not address companies' concerns, regardless of whether the companies were currently creditworthy. For example, no company, even a company that is strong today, wants to face a future where if the company confronts financial challenges, it may suddenly have a large PBGC liability for a previous business transaction, or be severely limited in its ability to engage in helpful future business transactions. And ironically, for companies that fail to satisfy PBGC's creditworthiness test, the application of Section 4062(e) and the resulting new liabilities could severely harm jobs and the company's recovery, which is in no one's interest, including the PBGC.

## THE ACT

The Act returns the law to Congress' original intent by ensuring that Section 4062(e) is not triggered unless there is a major business event with a substantial reduction in employment.

**Permanent cessation:** Under the Act, in order for there to be a 4062(e) event triggering liability, there must be a *permanent* cessation of operations at a facility in any location. Under the PBGC's enforcement position, as reflected in their proposed regulations, a temporary cessation of more than 30 days could have triggered liability, such as a cessation to repair a facility damaged by a hurricane or other natural disaster.

**Definitions of "facility" and "location":** The Act does not define the terms "facility" or "location," though the Harkin Statement addressed these points:

"[T]here may be questions as to how the terms "facility" and "location" should be interpreted. They are not explicitly defined in S. 2511 [the original Senate-passed bill with the same statutory language] because we intend for them to be interpreted according to their natural usage. For example, if an employer maintains several buildings that are physically adjacent to each other, that would be a single facility at a single location. However, if the employer maintains a building in one part of a city and another building in another part of the city, those buildings would be separate facilities at separate locations."

**Major cessation on a controlled group basis:** In addition, in order for there to be a 4062(e) event, there must be a "workforce reduction" of eligible employees at the facility of more than 15 percent of all eligible employees of the employer (which includes the entire controlled group of the plan sponsor). The total number of eligible employees is determined as of the date immediately before the earlier of (1) the date of the employer's decision to implement the cessation, or (2) the date of the first separation from employment taken into account under the three-year lookback rule described below. For these purposes, an eligible employee is an employee who is eligible to participate in any defined contribution or defined benefit plan established and maintained by the employer.

- **Facility-by-facility test:** For this purpose, only employees who separate from employment at the facility by reason of the cessation of operations at the facility are taken into account. However, unlike under prior law, employees need not be participants in a defined benefit plan in order to be taken into account as having separated from employment by reason of the cessation.
- **Relocations:** Employees are generally not treated as separating from employment if they are replaced by the employer at the same or another facility located in the United States, and the replacement is a citizen or resident of the

U.S. So, for example, if an employer moves its operations from one location to another location in the U.S., and some employees separate from employment rather than move, and those employees are replaced at the new location by U.S. citizens or residents, those employees are not treated as having separated from employment.

- **Dispositions:** Prior to the Act, if a facility was transferred in any way to another company, PBGC treated that as a cessation of operations, and treated the facility's employees as separating from employment, even if they continued working for the transferee company. Under the Act, in the case of a transfer of all or a portion of the operations at a facility to another employer – whether by a sale or other disposition of assets or stock of a contributing sponsor (or a member of its controlled group), or otherwise -- an eligible employee is not treated as having a separation from employment if:
  - The eligible employee is employed by the transferee company or replaced within a reasonable time by the transferee company with a U.S. citizen or resident, and
    - In the case of an eligible employee who is a participant in a defined benefit plan maintained by the transferor company, the transferee company assumes the portion of the assets and liabilities of the transferor company's defined benefit plan attributable to such employee, or
    - The eligible employee is not a participant in a defined benefit plan maintained by the transferor company.

This would cover situations, in addition to asset or stock sales, where an employee may become employed by a successor employer, such as the transfer of a government contract from one employer to another with an accompanying transfer of the employees. In such a situation, operations at the facility continue in an uninterrupted way, with perhaps no one losing their job.

- **Three-year lookback:** For purposes of determining whether there has been a 15 percent workforce reduction, there would be taken into account the separation from employment of any employee who (1) was eligible to participate in any defined contribution or defined benefit plan of the employer, (2) separated from employment at the facility during the three-year period preceding the cessation (disregarding employees who are not treated as having a separation by reason of the relocation or disposition rules described above), and (3) whose separation from employment is related to the permanent cessation of operations of the employer at the facility.

**Exemptions from rule.** Regardless of whether there has been a cessation of operations, an employer will not have liability with respect to a plan if for the plan year preceding the plan year of the cessation:

- There were fewer than 100 participants with accrued benefits under the plan as of the valuation date for the plan, or
- The plan's funded status is at least 90 percent, determined using the asset and liability rules applicable for purposes of determining a plan's liability for variable rate premiums. It appears that use of the alternative premium funding target is permitted for this purpose (and for the other purposes referenced below where the plan's liability for variable rate premium purposes is relevant), provided that such alternative is used for premium purposes.

**Optional liability:** The Act retains the pre-Act liability rules that apply when an employer has a 4062(e) event, but also gives an employer an option to satisfy such liability in a different way. If an employer elects such option, the employer must contribute, for each year for seven years, an amount equal to the product of (a) 1/7 of the plan's unfunded vested benefits (determined under the variable rate premium rules) for the plan year preceding the plan year in which the cessation occurred, multiplied by (b) the reduction fraction. The seven-year period generally begins with the plan year in which the cessation occurs, but please see below for situations where the seven-year period may start later.

- **Reduction fraction:** The reduction fraction is the quotient of (1) the number of participants with accrued benefits in the defined benefit plan who were counted as having separated from employment in computing the workforce reduction as a result of the cessation of operations at the facility, divided by (2) the number of participants in the defined benefit plan determined as of the same date that the number of all eligible employees of the employer is determined for purposes of the determination of whether there has been a 15 percent workforce reduction. There are important points to note about this rule.
  - This rule works differently than the rule for determining whether there has been a 15 percent workforce reduction. This rule only takes into account participants in a defined benefit plan.
  - There can be a reduction fraction for more than one defined benefit plan; correspondingly, under the optional liability rule, there can be liability with respect to more than one defined benefit plan. (This may also be an issue under the pre-Act liability rules applicable to the employer if the employer does not elect this optional liability amount.)

- **In addition to otherwise required minimum funding obligation:** The liability amount described above is in addition to the minimum funding obligation otherwise required with respect to the defined benefit plan, and credit balances cannot be used to satisfy such liability.
  - The additional contributions under this rule do not give rise to a credit balance (i.e., a prefunding balance).
  
- **Timing issues:** There are a number of timing issues that arise under the Act.
  - As noted above, contributions must be made for seven years, starting with the year in which the cessation occurs (except as noted below).
  - For each year in the seven-year period, the contribution is due by the earlier of (1) 8 ½ months after the end of the plan year, or (2) in the case of the first such contribution, the date that is one year after the date that the employer notifies the PBGC of the cessation or the date that the PBGC determines that a cessation has occurred. In the case of situations described in (2), subsequent contributions are due by the same date in the next year. This rule raises timing issues that are very well addressed in the Harkin Statement (which refers to the PBGC as the Corporation, as it is referred to in ERISA):
    - “S. 2511 is intended to prevent employers from being subject to retroactive liability and to other unreasonable payment deadlines. The legislation generally requires the first contribution under the alternative liability method to be paid not later than the earlier of (1) the due date for the minimum required contribution for the year in which the substantial cessation occurred and (2) in the case of the first contribution, the date that is one year after the later of (a) the date that the employer notifies the Corporation of the substantial cessation or (b) the date that the Corporation makes a final administrative determination that a substantial cessation has occurred and of the amount of the alternative liability (with subsequent contributions due on the same date in the following years). *The intent is to ensure that, in all cases, the employer has at least one year’s advance notice of the need to make the first contribution.*
    - “Thus, clause (2) controls where otherwise an employer could have less than a year’s advance notice of the liability. That is especially important where there is uncertainty as to whether a substantial cessation has occurred or regarding the alternative liability amount because the Corporation’s final determination might not even be made until after the due date for contributions for the year of the

substantial cessation. Similarly, the substantial cessation could occur in a year when the employer is not subject to Section 4062(e) liability pursuant to the Corporation's enforcement policy, but in a later year, the employer becomes subject to Section 4062(e) liability with respect to that earlier cessation. To prevent retroactive liability and other problems, clause (2) is controlling regarding the timing of the first contribution in all cases where the employer would otherwise have less than a year's advance notice of the liability. *Where clause (2) is controlling, the seven annual payments would start with the first one required by clause (2).*

- "In some cases, an employer may have notified the Corporation of a substantial cessation and elected the alternative liability method in a specific amount. We intend for the same timing rules to apply in determining the due date of the first payment of such amount. However, the Corporation may later challenge the amount of the alternative liability and seek a higher amount. In such cases, the higher amount would become due pursuant to the timing rules so that there may be separate seven-year periods, one for the originally elected amount and one for the higher amount determined by the Corporation." (emphasis added)
- The additional contributions are not subject to the quarterly contribution rules.
- **Cap on additional liability:** For any plan year, the contribution required under this rule cannot exceed the excess, if any, of (a) 25 percent of the excess, for the preceding plan year, of the plan's funding target for variable rate premium purposes over the fair market value of the plan's assets (also as determined for variable rate premium purposes), over (b) the minimum required contribution for the plan under the general funding rules.
- **Termination of obligation to make additional contributions:** Even if the seven-year period has not expired, the obligation to make the additional contributions to a plan ceases as of the year that the plan becomes 90 percent funded, as determined under the variable rate premium rules, provided that such year occurs on or after the first plan year in which the cessation occurs.
- **Election of the optional liability amount:** An election of the optional liability amount must be made within 30 days after the earlier of (1) the date that the employer notifies the PBGC of the cessation, or (2) the date that the PBGC determines that a cessation has occurred. This rule also raises timing issues that are addressed very well in the Harkin Statement:

- “S. 2511 is intended to allow employers to make conditional elections. The legislation allows employers that have a substantial cessation under Section 4062(e) to elect a new, alternative means of satisfying their liability. The election must be made not later than 30 days after the earlier of the date that the employer notifies the Corporation of a substantial cessation of operations or the date that the Corporation makes a final administrative determination both that a substantial cessation of operations has occurred and of the amount of the alternative liability. Of course, there may be instances in which it is uncertain as to whether such a cessation has occurred or the amount of the alternative liability, if any, even after a final administrative determination has been made by the Corporation. In those cases, the employer would certainly not be required to make a binding election to pay amounts that may later be determined not to be due. *Thus, in all cases, an election by the employer would become inapplicable to the extent that a court subsequently rules, or the Corporation later agrees, that a cessation has not occurred or that the alternative liability amount is lower than the amount determined by the Corporation.*
- “To the extent that an election becomes inapplicable, any contributions previously made by the employer to satisfy such inapplicable liability amount should be treated as additional funding contributions that are not subject to the provisions of the bill. Consequently, such additional funding contributions could be treated as increasing the employer’s prefunding balance. *In addition, we fully intend for the Corporation and the courts to have the power to stay, in whole or in part, an employer’s obligation to make alternative liability payments until the court has determined whether there has been a substantial cessation and/or the alternative liability amount.*
- “In other cases, a substantial cessation may have occurred, but there is no liability of any kind due to the Corporation’s enforcement policy. We expect that some employers may want to make an election of the alternative liability amount in case the employer’s financial condition changes and the Corporation asserts a liability under Section 4062(e). In such cases, the annual amount due under the alternative liability method would be zero until the Corporation makes a final administrative determination that the Corporation’s enforcement policy no longer applies to such employer. To ensure that a substantial cessation in one year cannot cause liabilities 10 or 20 years later, for example, the seven-year payment period for the alternative liability amount would include years in which the amount due is zero.
- “In order to ensure that any reporting requirement that may later be determined to apply is satisfied, an employer may notify the Corporation of an event that the employer does not believe constitutes a substantial



cessation of operations. If the employer informs the Corporation in writing, the notification will not trigger the 30-day period for making an election, and the 30-day period will begin when the employer agrees that the event constitutes a substantial cessation of operations or when the Corporation makes a final administrative determination to that effect and similarly determines the amount of the alternative liability.” [emphasis added]

**Enforcement of optional liability amount:** The obligation to make contributions pursuant to the optional liability rules exists only under ERISA, and does not exist under the Internal Revenue Code. The PBGC may go to court to compel an employer to make such contributions. Except as otherwise permitted by the PBGC, if an employer fails to make any required contribution in a timely manner, the rest of the contributions due during the seven-year period become immediately due. This acceleration rule is addressed in the Harkin Statement:

“Of course, any such acceleration should be stayed during the pendency of any administrative or judicial proceeding to determine whether there has been a substantial cessation and/or the amount of the alternative liability amount. In addition, if the Corporation or a court finds that the employer had a reasonable basis to contest any material portion of the Corporation’s determination, then the acceleration provision shall not apply (but the employer would owe past due payments plus interest).”

**Special rules:** A number of special rules apply, including several rules requiring notices to be provided in connection with the optional liability amount and a rule regarding funding waivers.

**Effective date:** Subject to the following exceptions, the new provisions apply to cessations of operations or other events at a facility that occur on or after the date of enactment, i.e., December 16, 2014.

- **PBGC is prohibited from taking actions inconsistent with the new rules with respect to pending cases.** PBGC is prohibited from taking any enforcement, administrative, or other action under Section 4062(e), or in connection with a settlement agreement relating to Section 4062(e), that is inconsistent with the new rules, without regard to whether the cessation or other event occurred before, on, or after the date of enactment. The only exception to this is for settlement agreements in place before June 1, 2014.
- **PBGC is prohibited from initiating a new enforcement action that is inconsistent with its enforcement policy in effect on June 1, 2014.** This means, for example, that the PBGC cannot pursue employers that satisfy PBGC’s creditworthiness test.

- **Ability to elect optional liability amount:** Employers that had a cessation prior to the date of enactment that is a 4062(e) event under the new rules may elect the optional liability amount not later than 30 days after the PBGC notifies the employer, on or after the date of enactment of the Act, of PBGC's final administrative determination that a 4062(e) event has occurred under the new rules; such event would be deemed to occur on the date of enactment. This rule does not apply if before the date of enactment of the Act, the employer entered into an arrangement with the PBGC to satisfy the requirements of Section 4062(e). The timing rules included in the Harkin Statement would apply to this election as well.

**STATEMENT OF SENATOR TOM HARKIN  
REGARDING S. 2511, AN AMENDMENT TO SECTION 4062(E) OF THE EMPLOYEE RETIREMENT  
INCOME SECURITY ACT OF 1974**

*Mr. President, as chairman of the Health, Education, Labor, and Pensions Committee, the pension community approached me with their concerns that the Pension Benefit Guaranty Corporation was interpreting section 4062(e) of the Employee Retirement Income Security Act of 1974 too broadly. That provision was intended to protect pension plan participants in the event of a cessation of operations at a facility. However, the pension community was able to provide substantial evidence that the Corporation's enforcement efforts were out of line with Congressional intent to such an extent that section 4062(e) had become a major impediment to businesses' efforts to restructure. After a thorough review of the situation and consultation with employers, employees, retirees, and the Obama Administration, it became abundantly clear that enforcement efforts under section 4062(e) were failing to protect either pensions or the Corporation.*

*Consequently, I worked with the Ranking Member, Senator Alexander, on a new approach that we introduced as S. 2511. That legislation, which passed out of Committee on a unanimous vote, will restore the original intent of section 4062(e) by clarifying the types of cessations of operations that trigger downsizing liability. The legislation will give plan sponsors certainty with respect to their obligations, and it will also ensure that participants are protected when workforce reductions signal that the ongoing viability of a plan sponsor is in question.*

*Overall, S. 2511 represents a significant compromise between the needs of employers, employees, and retirees, and I think it will give everyone a lot more clarity with regard to their obligations under section 4062(e). However, there are a few points about the bill that I would like to clarify.*

*First, there may be questions as to how the terms "facility" and "location" should be interpreted. They are not explicitly defined in S. 2511 because we intend for them to be interpreted according to their natural usage. For example, if an employer maintains several buildings that are physically adjacent to each other, that would be a single facility at a single location. However, if the employer maintains a building in one part of a city and another building in another part of the city, those buildings would be separate facilities at separate locations.*

*Second, S. 2511 is intended to allow employers to make conditional elections. The legislation allows employers that have a substantial cessation under section 4062(e) to elect a new, alternative means of satisfying their liability. The election must be made not later than 30 days after the earlier of the date that the employer notifies the Corporation of a substantial cessation of operations or the date that the Corporation makes a final administrative determination both that a substantial cessation of operations has occurred and of the amount of the alternative liability. Of course, there may be instances in which it is uncertain as to whether such a cessation has occurred or the amount of the alternative liability, if any, even after a final administrative determination has been made by the Corporation. In those cases, the employer would certainly*

*not be required to make a binding election to pay amounts that may later be determined not to be due. Thus, in all cases, an election by the employer would become inapplicable to the extent that a court subsequently rules, or the Corporation later agrees, that a cessation has not occurred or that the alternative liability amount is lower than the amount determined by the Corporation.*

*To the extent that an election becomes inapplicable, any contributions previously made by the employer to satisfy such inapplicable liability amount should be treated as additional funding contributions that are not subject to the provisions of the bill. Consequently, such additional funding contributions could be treated as increasing the employer's prefunding balance. In addition, we fully intend for the Corporation and the courts to have the power to stay, in whole or in part, an employer's obligation to make alternative liability payments until the court has determined whether there has been a substantial cessation and/or the alternative liability amount.*

*In other cases, a substantial cessation may have occurred, but there is no liability of any kind due to the Corporation's enforcement policy. We expect that some employers may want to make an election of the alternative liability amount in case the employer's financial condition changes and the Corporation asserts a liability under section 4062(e). In such cases, the annual amount due under the alternative liability method would be zero until the Corporation makes a final administrative determination that the Corporation's enforcement policy no longer applies to such employer. To ensure that a substantial cessation in one year cannot cause liabilities 10 or 20 years later, for example, the seven-year payment period for the alternative liability amount would include years in which the amount due is zero.*

*In order to ensure that any reporting requirement that may later be determined to apply is satisfied, an employer may notify the Corporation of an event that the employer does not believe constitutes a substantial cessation of operations. If the employer informs the Corporation in writing, the notification will not trigger the 30-day period for making an election, and the 30-day period will begin when the employer agrees that the event constitutes a substantial cessation of operations or when the Corporation makes a final administrative determination to that effect and similarly determines the amount of the alternative liability.*

*Third, S. 2511 is intended to prevent employers from being subject to retroactive liability and to other unreasonable payment deadlines. The legislation generally requires the first contribution under the alternative liability method to be paid not later than the earlier of (1) the due date for the minimum required contribution for the year in which the substantial cessation occurred and (2) in the case of the first contribution, the date that is one year after the later of (a) the date that the employer notifies the Corporation of the substantial cessation or (b) the date that the Corporation makes a final administrative determination that a substantial cessation has occurred and of the amount of the alternative liability (with subsequent contributions due on the same date in the following years). The intent is to ensure that, in all cases, the employer has at least one year's advance notice of the need to make the first contribution.*

*Thus, clause (2) controls where otherwise an employer could have less than a year's advance notice of the liability. That is especially important where there is uncertainty as to whether a*

*substantial cessation has occurred or regarding the alternative liability amount because the Corporation's final determination might not even be made until after the due date for contributions for the year of the substantial cessation. Similarly, the substantial cessation could occur in a year when the employer is not subject to section 4062(e) liability pursuant to the Corporation's enforcement policy, but in a later year, the employer becomes subject to section 4062(e) liability with respect to that earlier cessation. To prevent retroactive liability and other problems, clause (2) is controlling regarding the timing of the first contribution in all cases where the employer would otherwise have less than a year's advance notice of the liability. Where clause (2) is controlling, the seven annual payments would start with the first one required by clause (2).*

*In some cases, an employer may have notified the Corporation of a substantial cessation and elected the alternative liability method in a specific amount. We intend for the same timing rules to apply in determining the due date of the first payment of such amount. However, the Corporation may later challenge the amount of the alternative liability and seek a higher amount. In such cases, the higher amount would become due pursuant to the timing rules so that there may be separate seven-year periods, one for the originally elected amount and one for the higher amount determined by the Corporation.*

*Fourth, if an employer fails to pay the amount due for any year by the due date, the employer will be liable for the balance of all amounts due for subsequent years under the alternative liability method, though the Corporation may waive or settle such accelerated liability in its discretion. Of course, any such acceleration should be stayed during the pendency of any administrative or judicial proceeding to determine whether there has been a substantial cessation and/or the amount of the alternative liability amount. In addition, if the Corporation or a court finds that the employer had a reasonable basis to contest any material portion of the Corporation's determination, then the acceleration provision shall not apply (but the employer would owe past due payments plus interest).*

*S. 2511 is a common sense solution to the concerns of the pension community, and I appreciate the work of Senator Alexander, the members of the HELP Committee, and the Obama Administration in getting this important legislation across the finish line.*