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# **PBGC Liabilities: Corporate Exposure, Pitfalls and Strategies**

Navigating the Complexities of the Early Warning Program, Downsizing Liability, and Distress

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THURSDAY, OCTOBER 27, 2011

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

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Today's faculty features:

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# ***PBGC Liabilities: Corporate Exposure, Pitfalls and Strategies***

***Navigating the Complexities of the Early Warning Program,  
Downsizing Liability, and Distress and Involuntary Terminations***

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Strafford Publications, Inc.  
Webinar/Teleconference  
October 27, 2011

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Keightley & Ashner LLP

# Overview

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- ❑ PBGC Reporting: Traps for the Unwary
- ❑ “Early Warning Program” Negotiations
- ❑ Dealing with “Downsizing Liability”
- ❑ Distress and Involuntary Terminations
- ❑ Bankruptcy Claims and Disputes

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# ***PBGC Reporting: Traps for the Unwary***

# PBGC Reporting: Traps for the Unwary

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- Reportable events: watch out for multiples!
  - One set of facts may give rise to two events
  - One event may occur “for” two or more plans
  - Determine waivers, extensions, and required information separately for each event and each plan
- Use “optional” Form 10 (significantly reduced initial information submission)
- “Change in controlled group”
  - Covers merger of two entities within controlled group
  - Timing keyed to binding agreement, not closing



# PBGC Reporting: Traps for the Unwary (Cont.)

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- “Active participant reduction”
  - May occur any day without discrete “event”
  - May need to report twice in same plan year
  - Event may occur on “1/1” without any reduction
  - Spinoff may trigger event
  - 4062(e)/4063(a) notice: no waivers/extensions!
- Transfers of benefit liabilities
  - Generous waiver (PBGC “safe-harbor” assumptions)
  - But may be reportable active participant reduction!
- “Extraordinary dividend” reportable event
  - Does not match IRC definition
  - Captures significant value transfer to any other controlled group member (up, down, or sideways)

# PBGC Reporting: Traps for the Unwary (Cont.)

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- Significant changes on horizon . . . . .
  - Proposed rule (11/23/09) would eliminate most waivers and extensions, add new events, require more information
  - 2011 Blue Book announcement that PBGC will re-propose
- Prepare for significant changes . . . . .
  - Establish central point of contact within controlled group to ensure compliance
  - Consider effect on loan and other corporate agreements
- Form 200 filings: note unique PBGC methodology:
  - Pre-PPA: see PBGC Opinion Letter 2001-1
  - Post-PPA: see *proposed* Form 200 instructions at ([www.pb.gc.gov/Documents/Form\\_200\\_Instructions\\_proposed\\_rule\\_to\\_OMB.pdf](http://www.pb.gc.gov/Documents/Form_200_Instructions_proposed_rule_to_OMB.pdf))

# PBGC Reporting: Traps for the Unwary (Cont.)

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- ERISA Section 4010 reporting
  - Primary trigger:
    - One plan FTAP < 80%, *and*
    - CG-wide underfunding > \$15M
  - Watch out for the “other” reporting triggers (significant noncompliance, per PBGC):
    - \$1M+ lien, *or*
    - \$1M+ waivers
  - Note: PBGC regulations require you to report that you no longer need to report!

# PBGC Reporting: Penalties and Subpoenas

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- Penalty exposure up to \$1,100 *per day* for *each* person required to report or disclose
- “Guideline” penalties generally much lower
  - \$25 per day for first 90 days
  - \$50 per day thereafter
  - Reduced for plans with < 100 participants (*e.g.*, 60 participants: 60% x total) with \$5 daily floor
  - Overall cap of \$100 x participant count
- PBGC may assess penalty above or below “guideline” amount where warranted

# PBGC Reporting: Penalties and Subpoenas (Cont.)

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- Larger penalty may be warranted where:
  - Willful failure
  - Pattern or practice
  - Substantial harm to participants or PBGC
- PBGC normally assesses maximum penalty for Form 200 and *advance* reporting failures
- PBGC has discretion re whether/how much to assess/waive

# PBGC Reporting: Penalties and Subpoenas (Cont.)

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- “Reasonable cause” waiver guidance in *proposed* policy statement issued in 2001
  - Proposal, as general matter, still largely reflects PBGC’s current practices (per 2001 and 2010 Blue Books and 2009 ABA/JCEB Meeting Summary)
  - Note: *no* relief based on claim outside advisor responsible for failure (unless *advisor* has reasonable cause)
- Penalty authority applies only where time limit is specified in certain statutory/regulatory provisions
- PBGC may subpoena information, whether or not it is subject to penalty authority
- Comply with PBGC information requests!

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# ***“Early Warning Program” Negotiations***

# “Early Warning Program” Negotiations

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- PBGC focus: increased risk to PBGC and/or pension plans resulting from corporate transaction
  - Effect on credit quality of controlled group
    - Ability to fund pension plan going forward
    - Ability to satisfy employer liability if plan terminates
  - Changes in capital structure and effect on PBGC's/pension plan's position



# “Early Warning Program” Negotiations (Cont.)

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- Joint and several controlled group liability is key
  - Applies to:
    - Unpaid contributions
    - Ongoing/termination premiums (and penalties/interest)
    - Plan termination liability (unfunded benefit liabilities)
  - *Each* member liable for full amount
  - PBGC liens (\$1M+ missed contributions; portion of termination liability) can reach all controlled group property
  - All controlled group members are considered by PBGC in evaluating possible distress and PBGC-initiated terminations

# “Early Warning Program” Negotiations (Cont.)

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- Triggers for PBGC monitoring
  - Aggregate controlled group underfunding = \$50M+
  - Aggregate CG participant count = 5,000+
  - “Other reasons as appropriate”
- Criteria for PBGC-initiated termination
  - Minimum funding standard not met (missed annual “catch-up,” not missed quarterlies)
  - Plan “will be unable” to pay benefits when due (*mandatory* termination if *currently* unable)
  - Substantial owner distribution (rare)
  - “Long-run loss”: “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”

# “Early Warning Program” Negotiations (Cont.)

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- PBGC concerns
  - Breakup of controlled group
  - Transfer of plan to weaker controlled group
  - Movement of value between/among CG members
  - Highly leveraged transaction
  - Substitution of substantial secured for unsecured debt
- Primary PBGC leverage: “involuntary termination”
- “Long-run” loss analysis
  - Likelihood of future termination if PBGC does not act now
  - Expected increase in PBGC loss
- PBGC can quickly set termination date (publishes notice)
  - “Locks in” immediate termination date, related liability
  - But subject to later court approval or agreement with PA

# “Early Warning Program” Negotiations (Cont.)

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- Termination date
  - May be retroactive
  - But not before participant expectations extinguished
  - PBGC may seek later date for its own financial reasons
  - Subject to PPA’s “deemed” termination date of bankruptcy petition date
    - For certain purposes relating to Title IV benefits
    - Not for employer liability
- CBA *cannot* block PBGC-initiated termination

# “Early Warning Program” Negotiations (Cont.)

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- Other PBGC leverage possibilities
  - Potential fraudulent conveyance claims
  - “Evade or avoid” lawsuit
- Your leverage
  - Save jobs (political/public relations leverage)
  - Strength of post-transaction controlled group
- Consider contacting PBGC first (where contact is inevitable, it may be that the earlier, the better)

# “Early Warning Program” Negotiations (Cont.)

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- PBGC information requests
  - Timing flexibility *if* transaction not imminent
  - Protect confidentiality (confidentiality agreement and/or structure as reportable event follow-up)
  - Demonstrate viability of post-transaction CG!
- Settlement possibilities include:
  - Additional contributions to plan
    - May have other reasons to pay above minimum
    - Can't increase PFB, but can reduce future minimums
  - Retention of plan by strong seller
  - Guarantee by seller if future plan termination
  - Grant to plan or PBGC of security interest

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# ***Dealing with “Downsizing Liability”***

# Dealing with “Downsizing Liability”: Statutory Language

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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 “Downsizing Liability”: PBGC Stepped-Up Enforcement

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- Section 4062(e) “on the books” since 1974 but largely dormant for over 30 years
- Mid-2006: PBGC final rule contained “fix” for statutory liability formula problem
  - Statutory cross-reference to multiple-employer rules arguably always led to 100% of termination liability
  - Regulatory fix used headcount reduction fraction to determine percentage of termination liability
- Final rule set stage for enhanced PBGC enforcement

# Dealing with “Downsizing Liability”: PBGC Stepped-Up Enforcement (Cont.)

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## □ PBGC’s 2010 Annual Report:

“During FY 2010, PBGC opened 129 new 4062(e) cases, as compared with 105 in 2009 and 40 in 2008, and reached settlements with 20 companies for approximately \$250 million.”

## □ ABA Section of Taxation 2011 May Meeting presentation by PBGC Chief Counsel:

- PBGC “stepped up [its] activity”
- 4062(e) is “important part of [PBGC’s] risk mitigation program”

# Dealing with “Downsizing Liability”: PBGC Stepped-Up Enforcement (Cont.)

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- Several 2010 and 2011 PBGC press releases announcing 4062(e) settlements, including with:
  - BorgWarner (\$111M)
  - Affiliate of ThyssenKrupp (\$105M)
- 3/18/11 PBGC press release:

“Since 2007, under [the 4062(e) enforcement] program, the PBGC has obtained more than \$750 million in additional protection for defined benefit plans covering more than 80,000 workers and retirees.”

# Dealing with “Downsizing Liability”

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- ❑ Discretionary creditors rights tool, or downsizing penalty?
- ❑ 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”

# Dealing with “Downsizing Liability”: The Basics

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- Liability amount
  - Step 1: calculate employer liability (full plan)
    - Use conservative PBGC assumptions
    - Determine immediately *after* cessation date (include shutdown benefits)
  - Step 2: multiply by active participant percentage reduction
  - Example
    - Employer liability (full plan) = \$800M
    - Active participant percentage reduction = 25%
    - 4062(e) liability amount = \$200M

# Dealing with “Downsizing Liability”: The Basics (Cont.)

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- 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:
    - Bond cancelled
    - Escrowed funds returned (*without* interest)

# Dealing with “Downsizing Liability”: Reporting

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- Section 4063(a) notice due within 60 days
  - *Proposed* regulation provides that 60-day period starts on later of:
    - Date of cessation, and
    - Date 20% threshold crossed
  - No exemptions based on size, funding, etc.
  - All reportable event waivers/extensions inapplicable
- Form 10 (Active Participant Reduction Reportable Event) notice may also be required

# Dealing with “Downsizing Liability”: Reporting (Cont.)

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- ❑ Either 4063(a) notice or Form 10 notice may be due first
- ❑ Reasons for reductions are:
  - Relevant for 4063(a)
  - Not relevant (except for certain waiver/extension purposes) for Form 10 notice



# Dealing with “Downsizing Liability”: Reporting (Cont.)

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- *Proposed* change to 4063(a) reporting (8/10/10 proposed rule):
  - Plan administrator allowed to disregard separations at *other* facilities in determining whether/when to report
- *Proposed* changes to Form 10 reporting (11/23/09 proposed rule):
  - All existing waivers and extensions would be dropped
  - New waiver where active participant reduction reported within past year

# Dealing with “Downsizing Liability”: Open Issues

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- Unresolved interpretive issues abound:
  - Applicability to asset or stock sales
  - “Facility in any location”
  - “Cessation” of “Operation(s)”
  - “Separated from employment”
  - “Result of”

# Dealing with “Downsizing Liability”: Proposed Rule

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- Proposed rule (75 FR 48283, 8/10/10) provides guidance on applicability and enforcement of 4062(e)
- Proposed rule addresses many (not all) open issues
  - Not in effect
  - Could change in final rule (PBGC is “reconsidering”)
  - Even final rule interpretations could be challenged
- Resolution likely to be through PBGC settlement

# Dealing with “Downsizing Liability”: Proposed Rule (Cont.)

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- Proposal adopts expansive view re 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 the same facility (unclear)
  - The “operation” is replaced with another “operation”

# Dealing with “Downsizing Liability”: Proposed Rule (Cont.)

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- ❑ Public comments urged PBGC to reconsider proposal
- ❑ PBGC announced on 5/27/11 (Preliminary Plan for Regulatory Review) and again on 8/23/11 (Plan for Regulatory Review) that it will reconsider proposal
- ❑ Target publication date for final rule (per 7/7/11 semiannual regulatory agenda): November 2011 (now appears unlikely)
- ❑ Extent to which “reconsideration” will result in significant changes from proposal is unclear

# Dealing with “Downsizing Liability”: Proposed Rule (Cont.)

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- Proposed interpretation re multiple-employer plans:
  - 4062(e) liability not applicable
  - Proposed rule not applicable
- Proposed interpretation re “established and maintained”:
  - Statutory language: 4062(e) may apply only if plan is one “established *and* maintained” by the employer
  - PBGC: enough if just “maintained” by the employer

# Dealing with “Downsizing Liability”: Proposed Rule (Cont.)

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- Proposed treatment of risk (or lack of risk)
  - Not relevant in deciding whether 4062(e) event has occurred
  - May be relevant in making arrangements for satisfying resulting liability
- Proposed treatment of multiple plans: apply 4062(e) on plan-by-plan basis

# Dealing with “Downsizing Liability”: Proposed Rule (Cont.)

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- Applicability to “going concern” asset sales?
  - Operation(s) “cease(s)” *with seller*
  - Employees “separated from employment” *with seller*
  - But operation(s) and employment continue *with buyer*
  - PBGC Opinion Letters (*e.g.*, 76-52, 77-147, 78-29, and 82-29) found no 4062(e) liability
- PBGC proposal: “Going concern” asset sales are covered (assuming 20% threshold met)



# Dealing with “Downsizing Liability”: Proposed Rule (Cont.)

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- Applicability to stock sales?
  - Title IV “employer” definition: entire controlled group treated together as one “employer”
  - Operation(s) “cease(s)” *with (old) entire controlled group*
  - Employees “separated from employment” *with entire (old) controlled group*
  - But operation(s) and employment continue *with (new) entire controlled group and with the particular entity (e.g., a subsidiary) that is sold*
- PBGC proposal (unclear):
  - No explicit statement in preamble or regulatory text
  - However, use of “employer” in preamble and regulatory text arguably serves to cover stock sales

# Dealing with “Downsizing Liability”: Proposed Rule (Cont.)

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- “Facility in any location”
  - Two or more buildings across street or across town?
  - Geographically dispersed buildings conducting integrated “operation(s)”?
  - Two or more “facilities” in a single building?
- PBGC proposal:
  - Would define facility (or facility in any location) that is “associated with an operation” as “the place *or places* where the operation is performed” (emphasis added)
  - Would provide that a facility:
    - Is typically a building or buildings
    - May be or include any one or more enclosed or open areas or structures
    - May be associated with more than one operation

# Dealing with “Downsizing Liability”: Proposed Rule (Cont.)

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- “Operations”
  - Cessation of one set of “operations” with other “operations” at same “facility” continuing?
  - What constitutes discrete set of “operations”?
- PBGC proposal:
  - Would base event on cessation of any one “operation” (so that event could occur even if other operations at facility continue)
  - Would define “operation” as “a set of activities that constitutes an organizationally, operationally, or functionally distinct unit of an employer”

# Dealing with “Downsizing Liability”: Proposed Rule (Cont.)

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- PBGC proposal (cont.):
  - Would provide that whether a set of activities is an operation may depend on whether it is (or similar sets of activities are) so considered:
    - In the relevant industry
    - In the employer’s organizational structure or accounts
    - In relevant collective bargaining agreements
    - By the employer’s employees or customers, or
    - By the public

# Dealing with “Downsizing Liability”: Proposed Rule (Cont.)

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- “Cessation”
  - What if portion(s) of operation(s) continue(s) indefinitely?
  - How complete?
  - Work in progress?
  - How permanent?
  - Asset or stock sale where operation(s) continue(s) with buyer
- PBGC proposal:
  - Would provide that voluntary cessation occurs “when the employer discontinues all significant activity at the facility in furtherance of the purpose of the operation”
  - For discontinuance caused by employee action, would provide that cessation occurs when employee action ends (absent employer resumption within a week) or, if earlier, when employer decides not to resume

# Dealing with “Downsizing Liability”: Proposed Rule (Cont.)

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- PBGC proposal (cont.):
  - For discontinuance caused by “sudden and unanticipated event (other than employee action) such as a natural disaster,” would provide that cessation occurs on earlier of:
    - 30th day after discontinuance (unless employer has resumed) or
    - Date employer decides not to resume
  - Would disregard whether
    - Operation is continued or resumed at another facility or [in asset (or stock?) sale] by another employer, or
    - When the operation is discontinued, a different operation is undertaken
  - “[A]ny hope or expectation the employer may have that the discontinued work will be resumed would be irrelevant”

# Dealing with “Downsizing Liability”: Proposed Rule (Cont.)

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- “Separated from employment”
  - “Temporary” layoffs or layoffs with long-term recall rights?
  - Effect of reinstatement or replacement hires?
  - Asset or stock sale where employment continues with buyer?
- PBGC proposal:
  - General rule: Separation from employment would occur “when the employee discontinues the active performance, pursuant to the employee’s relationship with the employer, of activities in furtherance of any of the employer’s operation”
  - Short-term layoff exception:
    - Separation would not occur if reasonably certain employee will resume active work for employer within 30 days
    - However, if no resumption within 30-day period, separation considered to have occurred upon discontinuance

# Dealing with “Downsizing Liability”: Proposed Rule (Cont.)

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- PBGC proposal (cont.):
  - Reinstatement exception: Pre-cessation-date separation would not count if, as of cessation date, employee rehired and is:
    - Employee of employer, and
    - Participant in affected plan
  - Replacement exception: Pre-cessation-date separation would not count if, as of cessation date, employee replaced and replacement employee is:
    - Employee of employer, and
    - Participant in affected plan
  - Asset (and stock?) sales: “[T]he fact that a person previously employed by the original employer continues to work in the operation as an employee of the new employer does not mean that the person has not separated from employment (with the original employer).”



# Dealing with “Downsizing Liability”: Proposed Rule (Cont.)

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- “Result of”
  - Normal attrition?
  - Employees who voluntarily quit or retire
    - In anticipation of cessation?
    - Having previously planned to quit or retire?
  - Employees involuntarily separated for (arguably) other reasons?
  - Can “cessation” at Facility A “result” in separation at Facility B?
- PBGC proposal:
  - General rule: “Result” test is met if “separation would not have occurred when it did if [cessation] had not occurred,” regardless of whether employee:
    - Separates before, on, or after cessation date,
    - Is employed in operation that ceased, or
    - Is employed at facility associated with operation that ceased

# Dealing with “Downsizing Liability”: Proposed Rule (Cont.)

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- PBGC proposal (cont.):
  - Presumption for voluntary cessation with involuntary separation: “Result” test presumed met if involuntary separation occurs on or after date employer *decides* to cease operations
  - Presumption for voluntary cessation with *voluntary* separation: “Result” test presumed met if voluntary separation occurs on or after date employer cessation decision becomes known
  - Presumption for *involuntary* cessation: “Result” test presumed met if voluntary or involuntary separation occurs on or after date of event causing the cessation
  - Presumption for employment by new employer: “Result” test presumed met if new employer continues or resumes operation at same or different facility and employs the employee
  - All presumptions could be rebutted by appropriate evidence

# Dealing with “Downsizing Liability”: Proposed Rule (Cont.)

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- Determining the denominator
  - Does regulatory language for liability fraction (“immediately before the cessation”) apply to 20% threshold test?
  - Include participants not accruing benefits (frozen plan)?
  - What about changes in numbers during (possibly extended) pre-cessation downsizing period, including changes on or after
    - Cessation decision date?
    - Date of event causing cessation?
- PBGC proposal:
  - Use same “Active Participant Base” as denominator for both 20% threshold test and liability fraction

# Dealing with “Downsizing Liability”: Proposed Rule (Cont.)

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- PBGC proposal (cont.):
  - Active Participant Base is number of individuals who are employees of employer and participants in plan, determined
    - Using same test for “employment” status as under proposed test for “separated from employment” (see Slides 43-44)
    - Treating individual as plan participant regardless of whether benefits are accruing (frozen plan)
    - Based on number immediately before date of
      - Employer cessation decision in voluntary cessation
      - Event causing cessation in involuntary cessation

# Dealing with “Downsizing Liability”: Proposed Rule (Cont.)

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- ❑ Proposed compliance deadlines for PBGC investigative requests for information
- ❑ 60-day period under 4063(a) would start at later of cessation date or date 20% threshold crossed
- ❑ Mandatory forms for plan administrator
  - Employer must provide information to plan administrator
  - Substantial initial information requirements
  - PBGC follow-up requests possible (likely)
  - Continuing obligation to report if filed information determined to be materially wrong or outdated
  - Plan administrator may disregard separations at other facilities for filing purposes (but subject to PBGC follow-up)

# Dealing with “Downsizing Liability”: Proposed Rule (Cont.)

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- Proposed substantial penalties for late filings
  - General “guideline” daily penalties (generally, \$25/\$50) may not apply to late 4063(a) notice
  - Because failures “may well result in substantial harm to participants and PBGC,” larger daily penalties may apply
  - Maximum daily penalty per statute is \$1,100
- UBL determination as of immediately after cessation date would disregard later changes in assets/liabilities

# Dealing with “Downsizing Liability”: Proposed Rule (Cont.)

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- ❑ Would preserve PBGC ability to negotiate alternatives to statutory escrow or bond options
- ❑ Would impose 5-year recordkeeping requirement
- ❑ Would allow for PBGC case-by-case waivers, but no automatic waivers, for:
  - Small plans
  - Well-funded plans, or
  - Plans undergoing standard terminations
- ❑ Regulation would “displace and supersede all of PBGC’s prior opinion letter pronouncements” on 4062(e)
- ❑ Proposed rule would apply to cessations on or after effective date of final rule

# Dealing with “Downsizing Liability”: Settlement

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- Statutory liability
  - *Not* self-executing
  - Serves as starting point for negotiations
- Key PBGC focus
  - Exposure
    - Current underfunding, expected recoveries
    - Projected 5-year underfunding, expected recoveries
  - Risk
    - Controlled group financial distress
    - Historical and projected financial statements
    - EBITDA, free cash flow, projected contributions
    - Joint/several controlled group liability (including foreign)



# Dealing with “Downsizing Liability”: Settlement (Cont.)

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- 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)
- Negotiating leverage for PBGC
  - Ability to file suit to enforce 4062(e) liability
  - Effect filing of lawsuit, or even mere assertion of liability in a letter, could have on:
    - Loan/other agreements (*e.g.*, covenants, notice, default)
    - SEC disclosures
    - Credit ratings
    - Current or prospective lenders/investors

# Dealing with “Downsizing Liability”: Settlement (Cont.)

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- Negotiating leverage for employer
  - Trigger not met (unresolved interpretive issues)
  - Dispute liability amount (unresolved interpretive issues)
  - Little/no risk of plan termination within 5 years
  - Downsizing will make employer stronger
  - 4062(e) liability would increase failure risk
  - Preserve jobs
- PBGC tends to be flexible on how to satisfy liability, but not on amount (per PBGC) of liability

# Dealing with “Downsizing Liability”: Settlement (Cont.)

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- Settlement possibilities (may be “mix and match”)
  - Waiver of existing carryover or prefunding balance
  - Additional contributions
    - Will likely require agreement not to create or increase prefunding balance
    - May be over period of several years
    - Will reduce funding shortfall and, therefore, future minimum required contributions
    - PBGC may insist on securing commitment to make additional contributions

# Dealing with “Downsizing Liability”: Settlement (Cont.)

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- 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 “Downsizing Liability”: Settlement (Cont.)

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- Effect of 5-Year 4062(e) window
  - Employer generally wants to limit deal to 5-year window
  - PBGC likely to push for protection beyond 5-year window
  - Extra contributions/credit balance waivers naturally extend beyond window
  - Employer willingness to extend beyond 5-year window can “buy” less onerous deal
  - Ambiguity and potential for lengthy litigation: employer leverage (5-year shelf life)
  - Potential for future PBGC involuntary termination threat where protection disappears at end of 5-year window

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# ***Distress and Involuntary Terminations***

# Distress and Involuntary Terminations

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- If plan is underfunded, only way to terminate voluntarily is through “distress termination”
- CBA can block distress termination--1113 motion possible
- *Each* controlled group member must meet at least 1 test:
  - Distress Test 1: Liquidation in bankruptcy/insolvency
  - Distress Test 2: Reorganization in bankruptcy
  - Distress Test 3: Inability to continue in business
  - Distress Test 4: Unreasonably burdensome pension costs
- Each CG member may meet different test
- Distress terminations usually arise in bankruptcy setting (liquidation/reorganization)

# Distress and Involuntary Terminations (Cont.)

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- ❑ Liquidation distress test (Test 1): automatic
- ❑ Reorganization distress test (Test 2): often contested
  - Show “meaningful sacrifices” in all areas
  - Show plan unaffordable even w/freeze & waiver
  - If lender/investor insists on plan termination, show:
    - ❑ Lender/investor has sound financial basis
    - ❑ Inability to find lender/investor not insisting on termination
  - Multiple plans: PBGC argues for plan-by-plan analysis
  - Watch out for any *non-debtor* controlled group members (each one must also meet distress!)
  - Watch out for “follow-on” replacement plans (major PBGC concerns!)



# Distress and Involuntary Terminations (Cont.)

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- Distress permitted outside bankruptcy under Tests 3/4
  - PBGC makes determination
  - Can be useful for small to mid-size employer where bankruptcy not otherwise needed, too costly, etc.
  - Business continuation test (Test 3) analogous to reorganization test (Test 2)
  - Filing should include convincing argument/evidence re austerity measures, consideration of alternatives, etc.
  - Contribution projections and financial projections drive Test 3 affordability analysis
  - PBGC follow-up questions likely during review
  - Test 4 very rarely used to date (some overlap w/Test 3)

# Distress and Involuntary Terminations (Cont.)

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- Distress procedures
  - Various notices and filings (tracks standard termination process, but with significant differences)
  - Restrictions on lump sums (even de minimis) and annuity purchases
  - Cutbacks of benefits to estimated Title IV levels
  - Enrolled actuary must estimate values of Title IV benefits and of benefit liabilities (Schedule EA-D)
  - Process can take months or even years
    - No specific deadline for PBGC to decide distress
    - Alert PBGC if fast action is needed to save employer, jobs!
  - Don't forget "net worth" notice and submission!

# Distress and Involuntary Terminations (Cont.)

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- Involuntary (PBGC-initiated) terminations
  - May be used/threatened to block corporate transaction:
    - Breakup of controlled group
    - Transfer of plan to weaker controlled group
    - Movement of value between/among CG members
    - Highly leveraged transaction
  - May be used to cut off PBGC guarantee exposure
  - Possible “triggers” include reportable event notices and “Early Warning Program” monitoring
  - Often used for abandoned plans, distress “shortcut”
  - Often done by agreement with plan administrator
  - Don’t forget “net worth” notice and submission!

# Distress and Involuntary Terminations (Cont.)

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- Criteria for involuntary terminations
  - Minimum funding standard not met (missed annual “catch-up,” not missed quarterlies)
  - Plan “will be unable” to pay benefits when due (*mandatory* termination if *currently* unable)
  - Substantial owner distribution (rare)
  - “Long-run loss”: “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”
- “Long-run” loss analysis
  - Likelihood of future termination if PBGC does not act now
  - Expected increase in PBGC loss

# Distress and Involuntary Terminations (Cont.)

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- PBGC can quickly set termination date by publishing notice
  - “Locks in” immediate termination date, related liability
  - Subject to later court approval or agreement with PA
- Termination date
  - May be retroactive
  - But not before participant expectations extinguished
  - PBGC may seek later date for financial reasons
- CBA *cannot* block PBGC-initiated termination

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# ***Bankruptcy Claims and Disputes***

# Bankruptcy Claims and Disputes

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- Key PBGC concerns
  - Adequate information in disclosure statement
  - Funding of plan during bankruptcy
  - Future of plan
    - Ongoing
    - Standard termination
    - Distress or PBGC-initiated termination
  - Treatment of PBGC claims
- PBGC bankruptcy claims
  - Many priority arguments raised by PBGC
  - Most arguments rejected by courts
  - Usually resolved with “global” PBGC settlement

# Bankruptcy Claims and Disputes (Cont.)

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- Potential PBGC “post-bankruptcy” liability
  - “Exit fee” (“termination premium”) for PBGC-initiated terminations and non-liquidation distress terminations
    - \$1,250 per participant, per year, for 3 years
    - For employers in bankruptcy reorganization, 3-year period starts post-confirmation
  - *Oneida* decision (survives reorganization intact)
  - If future case law follows *Oneida*, may lead to more asset sales followed by liquidations



# Bankruptcy Claims and Disputes (Cont.)

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- Guarantor claims
  - Unpaid premiums
    - General unsecured if plan year starts pre-petition
    - Check PBGC calculation methodology!
  - “Unfunded Benefit Liabilities”
    - Contingent on plan termination
    - Often filed as unliquidated claim
    - Disputes re amount: based on PBGC valuation regulation assumptions (controversial)
    - Disputes re priority: PBGC claims tax status (30% of aggregate positive CG net worth), but courts reject

# Bankruptcy Claims and Disputes (Cont.)

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- Successor trustee claims
  - Unpaid contributions
    - Contingent on plan termination and PBGC trusteeship
    - Tax status arguments (\$1M+) rejected by courts
    - Post-petition “administrative” priority
      - Limited (at most) to normal cost
      - Reduce for decline in employment levels
    - Limited priority for 180-day pre-petition period
    - Rest is general unsecured
  - Shortfall amortization claim (ERISA Section 4062(c))
  - Fiduciary breach (not common)

# Bankruptcy Claims and Disputes (Cont.)

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- Resolving claims with PBGC
  - Settlement common
  - Actuary to actuary (plan/PBGC): agree on numbers
  - Attorney to attorney (debtor/PBGC): resolve priority and (for UBL claim) amount disputes
  - Existence of non debtor controlled group members (particularly if foreign) can complicate settlement
  - End result:
    - May be single sum
    - If good “test case” for PBGC, settlement may not occur

# Questions?

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