GROOM LAW GROUP

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TITLE IV BASICS

I. Introduction

Title IV of the Employee Retirement Income Security Act of 1974, as amended ("ERISA") describes the plan termination insurance program that covers defined benefit pension plans. A defined benefit pension plan covered by Title IV of ERISA can be terminated only by following the termination procedures in Title IV. Termination --

A. Stops future benefit accruals.

B. Stops future minimum funding obligations.

C. Matures PBGC's claim for unfunded benefit liabilities.

II. Plan Termination

An underfunded, defined benefit pension plan may be terminated through a "distress" termination initiated by the plan administrator or through an "involuntary" termination initiated by PBGC.

A. Distress Termination

1. A plan administrator initiates a distress termination by issuing a notice of intent to terminate to all plan participants and beneficiaries, unions, if any, and the PBGC, proposing a date of plan termination that is at least 60 but not more than 90 days after the date the notice is issued. 29 U.S.C. § 1341(c)(1)(A).

2. The plan sponsor and each member of its controlled group must meet one of four distress tests specified by statute. 29 U.S.C. § 1341(c). The two most commonly used distress tests are the "reorganization" distress test and the "business continuation" distress test.

a. Under the reorganization distress test (i) the company must be in reorganization in bankruptcy or insolvency proceedings and (ii) the bankruptcy court must find that unless the plan is terminated, the company will be unable to pay all its debts pursuant to a plan of reorganization and will be unable to continue in business outside the chapter 11 reorganization.

b. Under the business continuation distress test, the company must demonstrate to PBGC that, unless a distress termination occurs, the company will be unable to pay its debts when due and will be unable to continue in business.

3. To complete a distress termination, the plan administrator submits documents to PBGC demonstrating that the plan sponsor and its controlled group members meet

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one of the distress tests. PBGC reviews the information, and information concerning the assets and liabilities of the plan, and determines whether all of the conditions for a distress termination have been met. 29 U.S.C. § 1341(c)(1). If so, PBGC and the plan administrator enter into an agreement to terminate the plan as of the proposed date of plan termination and to appoint PBGC trustee of the plan. 29 U.S.C. § 1341(c)(3)(B)(iii).

4. Significantly, PBGC is not permitted to continue processing a distress termination when the agency is notified of a challenge to the termination under an existing collective bargaining agreement. 29 U.S.C. § 1341(a)(3). In that event, PBGC stops processing the termination until it is notified that the challenge has been resolved to permit the termination to proceed.

B. Involuntary Termination

1. PBGC may initiate a so-called "involuntary" termination, at its discretion, upon making one of four statutory findings.[1] Two of the findings potentially relevant here are (1) the plan has not met the minimum funding standard and (2) PBGC's possible long run loss with respect to the plan may increase unreasonably if the plan is not terminated. 29 U.S.C. § 1342(a)(1), (4).

a. In PBGC's view, a "failure to meet minimum funding" does not occur until a funding deficiency arises. In other words, missing a quarterly payment would not permit PBGC to make this finding.

b. PBGC applies the "long run loss" standard by comparing its liability risk with respect to the plan assuming a termination *before* a transaction to its liability risk with respect to the plan assuming a termination *after* the transaction. If the transaction, for example, would substantially increase plan liabilities or reduce PBGC's ability to collect termination liability, PBGC could conclude that it faces a long run loss if the plan is not terminated.

2. Upon making one of the four findings, PBGC can enter into an agreement with the plan administrator terminating the plan as of a proposed termination date and appointing PBGC trustee of the plan, thus avoiding litigation over termination. *See Jones & Laughlin Hourly Pension Plan v. LTV Corporation*, 824 F.2d 197 (2d Cir. 1987).

3. Alternatively, if the plan administrator does not agree to the termination, PBGC can ask a court to order termination of the plan based on a finding that termination is necessary to protect the interest of plan participants, or to avoid any unreasonable deterioration of the financial condition of the plan or any unreasonable increase in PBGC's liability. 29 U.S.C. § 1342(c).

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[1] PBGC is *required* to initiate a termination if a plan does not have assets available to pay benefits currently due under the plan. 29 U.S.C. § 1342(a).

4. Unlike a "distress" termination initiated by the plan administrator, an involuntary termination may proceed notwithstanding the plan sponsor's collective bargaining obligation to continue the plan. 29 U.S.C. § 1341(a)(3).

C. Date of Plan Termination

The date of plan termination is significant because it is the date as of which benefit accruals stop, contribution obligations stop, and liability to PBGC is measured.

1. In a distress termination, the date is the date chosen by the plan administrator, at least 60 but not more than 90 days before the plan administrator issues the notice of intent to terminate.

2. In an involuntary termination, the date may be set by agreement between PBGC and the plan administrator or, if they do not agree, by the court. Generally, courts have required a termination date on or after plan participants have received actual or constructive notice that the plan will be terminated.

a. PBGC is not required to provide individual, written notice to participants that it is seeking termination, but may provide notice by publishing notices in newspapers where participants live and work.

b. Where the plan already is frozen or the plan sponsor is liquidating or out of business, participants may have constructive notice that they are no longer accruing benefits under the plan.

c. In rare cases, a court will establish a retroactive date of plan termination to protect PBGC's financial interests.

III. Effect of Plan Termination

A. When an underfunded plan is terminated, PBGC is appointed trustee of the plan, takes over the assets of the plan, and pays benefits under the plan up to the amounts permitted by law.

1. The guaranty cap is $54,000 at age 65 for plans that terminate in 2009. This amount is actuarially adjusted for joint and survivor annuities and for retirement ages below and above 65. Participants who have retired or could have retired three years before the date of plan termination may receive more, depending on the plan's funded level.

2. Participants and beneficiaries do not have claims against the plan sponsor for the difference between the benefit paid by PBGC and the benefit they would have received if the plan had been fully funded upon termination. *E.g.*, *Adams Hard Facing v. PBGC*, 129 B.R. 662 (Bankr. W.D. Okla. 1991) (disallowing participants' claims against debtor for non-guaranteed benefits because PBGC is required to collect and distribute non-guaranteed benefits);

United Steelworkers of America v. United Engineering, Inc., 839 F. Supp. 1279 (N.D. Ohio 1993), *aff'd*, 52 F.3d 1386 (6th Cir. 1995) (participants do not have action for non-guaranteed benefits under ERISA or section 301 of the LMRA); *In re Lineal Group, Inc.*, 226 B.R. 608 (Bankr. M.D. Tenn. 1998) (denying early retirees' estoppel claims for non-guaranteed benefits under *Adams Hard Facing* reasoning).

B. Liability to PBGC

1. When an underfunded, defined benefit plan terminates in a distress or involuntary termination, PBGC has three types of claims: (1) a claim for the difference between the value of all accrued liabilities under the plan on the date of plan termination and the value of plan assets on the date of plan termination, calculated using assumptions established in PBGC regulations ("termination liability"), (2) a claim for unpaid contributions to the plan, if any, pro-rated to the date of plan termination ("unpaid contribution"), and (3) claims for PBGC premiums. 29 U.S.C. §§ 1362(b), (c), 1306(a)(3). (7).

a. PBGC premiums consist of annual flat-rate and variable-rate premiums, which are due until a plan is terminated, and a termination premium, which is due after the plan terminates. The termination premium generally is $1,250 times the number of participants in the plan immediately before the plan termination, and are due each year for a period of three years.

b. The termination premium arises unless the plan is terminated in a "liquidation distress" termination, *i.e.*, a distress termination based on the liquidation of the plan sponsor and each member of its controlled group.

c. Under the general rule, the premium is payable with respect to each of the three consecutive 12-month periods beginning with the first month following the month in which the date of termination occurs. ERISA § 4007(a)(7)(C). Under a special rule, if the plan is terminated in a reorganization distress or involuntary termination "during the pendency of any bankruptcy reorganization proceeding under chapter 11" or under similar state law, the premium is payable "with respect to" each of the three consecutive 12-month periods beginning with the first month following the month in which the date of discharge or dismissal occurs. ERISA § 4006(a)(7)(B), (C).

d. The Second Circuit has found that, where a debtor reorganizes in chapter 11, the claim for termination premiums is not discharged in bankruptcy because it does not arise until after discharge. <u>PBGC v. Oneida Ltd.</u>, 562 F.3d 154 (2d Cir. 2009) ("an employer's obligation to pay a Termination Premium on a pension plan that is terminated during the course of the bankruptcy does not even arise until the bankruptcy itself is terminated. No matter how broadly the term 'claim' is construed, it cannot extend to a right to payment that does not yet exist under federal law.").

e. Another court has found that the termination premium does not arise if the debtor liquidates in Chapter 11 because there is no discharge or dismissal. <u>USA Commercial Mortgage</u>, Case No. 06-10725 (LBR), Transcript of Record at 63.

2. Termination liability, unpaid contribution liability, and premium liability are joint and several obligations of the plan sponsor and each member of its controlled group. Generally, a controlled group is a group of trades or businesses linked by at least an 80% ownership interest (parent–subsidiary) or two or more trades or businesses at least 80% owned by five or fewer persons (brother-sister), or a combination of the two. Internal Revenue Code ("IRC") § 414(b), (c).

a. This means that PBGC may, at its option, seek payment of 100 percent of the joint and several obligation from any one or more controlled group members, but may not collect more than 100 percent of the amount owed. In bankruptcy, PBGC files its entire claim separately against each debtor in the controlled group and can pursue its claim against non-debtor controlled group members as well.

b. There is no provision in ERISA for allocating unpaid contributions or controlled group liability among controlled group members. *See PBGC v. Ouimet Corp.*, 711 F.2d 1085 (1st Cir. 1983);

3. Amount of PBGC's termination liability claim –

a. Is determined using conservative assumptions in PBGC regulations. Generally, the assumptions are intended to produce a benefit liability value that tracks the cost of purchasing an annuity contract from an insurer to provide the benefits.

b. Two courts of appeals have found that the amount of PBGC's termination liability claim may be recalculated in bankruptcy using a "prudent investor rate" to determine the present value of plan liabilities. *In re CSC Industries, Inc.*, 232 F.3d 505 (6th Cir. 2000); *In re CF&I Fabricators of Utah*, 150 F.3d 1293 (10th Cir. 1998), *cert. denied,* 526 U.S. 1145 (1999). *See In re Chateaugay Corp.*, 115 B.R. 760 (Bankr. S.D.N.Y. 1990) and 126 B.R. 165 (Bankr. S.D.N.Y. 1991) (proposed findings), *aff'd* 130 B.R. 690 (S.D.N.Y. 1991), *vacated, op. withdrawn*, 17 E.B.C. 1102 (S.D.N.Y. 1993). The prudent investor rate is the long term rate of return a plan could expect to receive from a portfolio prudently invested in stocks, bonds and the like. The prudent investor rate can be substantially higher than the discount rate in PBGC's regulation, which can result in a substantially lower termination liability claim.

c. More recently, however, courts have rejected the prudent investor rate theory and applied PBGC's regulation to determine the amount of PBGC's termination liability claim. *E.g.*, *In re US Airways Group, Inc.*, 296 B.R. 734 (Bankr. E.D. Va. 2003); *Dugan v. PBGC*, 382 B.R. 550 (Bankr. N.D. Ga. 2008); *see In re Wolverine, Proctor & Schwartz,* No. 06-10815-JNF, 2009 WL 1271953 (Bankr. D. Mass. May 5, 2009) (noting divergent case law and collecting cases); *In re Kaiser Aluminum*, 339 B.R. 91 (D. Del. 2006) (same).

4. Lien and priority status

a. If PBGC's termination liability claim is not paid upon demand, a lien arises in the amount of the lesser of the termination liability or 30 percent of the net worth of the plan sponsor and its controlled group. 29 U.S.C. § 1368(a). PBGC may perfect this lien to obtain a security interest in the assets of the plan sponsor and controlled group members if the entities are not protected by the automatic stay in bankruptcy.

b. In bankruptcy PBGC's claim for termination liability is treated as a general unsecured claim. *PBGC v. Skeen (In re Bayly)*, 163 F.3d 1205 (10th Cir. 1998).

c. Unpaid contribution claims attributable to pre-petition services generally are treated as general unsecured claims, except that contributions attributable to service during the 180 days before filing receive priority treatment under section 507(a)(4) of the Bankruptcy Code. *PBGC v. CF&I Fabricators of Utah, Inc. (In re CF&I Fabricators of Utah, Inc.)*, 150 F.3d 1293 (10th Cir. 1998). Contributions attributed to post-petition service may receive administrative priority treatment. *PBGC v. Sunarhauserman, Inc. (In re Sunarhauserman, Inc.)*, 126 F.3d 811 (6th Cir. 1997) (limiting PBGC's administrative priority claim to the portion of the minimum funding payments that relate to benefits and expenses accruing post-petition (the so-called "normal cost" component). *But see Columbia Packing Co v. PBGC*, 81 B.R. 205 (D. Mass. 1988) (extending administrative priority to both the normal cost and the past service liability elements of the minimum funding obligation that accrued post-petition).

d. The Sixth Circuit has found that obligations under a collective bargaining agreement are entitled to priority status until the obligation has been modified in accordance with section 1113 of the Bankruptcy Code, regardless of whether the claims otherwise would meet the requirements for administrative priority status under the Bankruptcy Code. *United Steelworkers of America v. Unimet Corp.*, 842 F.2d 879, 882 (6th Cir. 1988). Accordingly, in the Sixth Circuit, an obligation under a collective bargaining agreement to contribute to a plan could give unpaid contribution claims administrative priority until the bargained obligation has been modified under section 1113.

e. Other courts that have addressed the issue, however, continue to apply the Bankruptcy Code test for administrative priority to obligations required under a collective bargaining agreement. *E.g., In re Ionosphere Clubs, Inc.*, 22 F.3d 403 (2d Cir. 1994) (claims for pre-petition vacation pay under collective bargaining agreement not entitled to administrative priority); *In re Roth American, Inc.*, 975 F.2d 949 (3d Cir. 1992) (claims for pre-petition vacation and severance pay under collective bargaining agreement not entitled to administrative priority); *Adventure Resources, Inc. v. Holland*, 137 F.3d 786 (4th Cir. 1998) (contributions to multiemployer plans attributable to pre-petition services not entitled to administrative priority).

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