

August 13, 2010

MEMORANDUM TO CLIENTS

RE: PBGC Proposes To Regulate Funding of Ongoing Plans Sponsored by Companies That Restructure Their Operations

On August 10, 2010, the Pension Benefit Guaranty Corporation ("PBGC") proposed a regulation under which PBGC, pursuant to section 4062(e) of ERISA, would require a significant subset of employers that sponsor defined benefit pension plans to, in practice, fund their plans above the level required by the Pension Protection Act of 2006 ("PPA"). 75 Fed. Reg. 48283 (August 10, 2010).

Groom Law Group will hold a complimentary dial-in on the proposed regulation for our clients and friends of the Firm on September 9, 2010 at 12:00 PM EST.

Four years ago this month, Congress enacted and the President signed the PPA. PPA imposed new funding requirements on defined benefit pension plans based on "yield curve" interest rates. Less than two months ago, Congress modified these requirements to provide funding relief for defined benefit pension plans, giving single-employer plans longer than the seven year period usually required to amortize certain unfunded benefit liabilities.

In contrast to the actuarial assumptions governing ongoing plans under PPA, when a defined benefit plan terminates, PBGC computes the unfunded benefit liabilities of the plan using more conservative actuarial assumptions that generally yield a larger unfunded benefit liability than PPA assumptions. PBGC's rationale for using these assumptions is that, when a plan terminates, more conservative annuity or "close-out" assumptions are appropriate. When Congress was considering PPA, PBGC argued that even more aggressive funding rules should be adopted for certain ("highly underfunded") ongoing pension plans, but Congress ultimately rejected PBGC's position. Statement of Steven A. Kandarian, Executive Director, Pension Benefit Guaranty Corporation, Before the Committee on Education and the Workforce, United States House of Representatives (Sept. 4, 2003).

Notwithstanding Congress's decision, PBGC's proposed regulation would, in effect, impose funding requirements greater than those imposed by PPA that could be triggered by a variety of ordinary business transactions, including:

- Relocation of an operation from one facility to another;
- Sale of an operation to an unrelated company, with or without the transfer of some or all of the pension plan liabilities associated with the operation;
- Cessation of an operation at a facility and commencement of a new operation in the same facility.

Significantly, PBGC expressly states that, in determining whether section 4062(e) applies, it is irrelevant whether such a transaction would strengthen the employer's operations or

would pose no risk to the pension plan. Preamble at 48284-85; Proposed 29 C.F.R. § 4062.23(b). This approach therefore does not target situations that could give rise to plan termination, but rather, opportunistically focuses on business transactions that may or may not pose any risk to pension plans, plan participants, or PBGC.

While section 4062(e) has been part of ERISA since its enactment in 1974, PBGC has taken varying approaches to its meaning and enforcement over the years. Certain provisions of the proposed regulation are at odds with the plain meaning of terms in the statute and are inconsistent with positions PBGC has taken under section 4062(e) in the past. Indeed, the preamble explains that the regulation would nullify all prior PBGC opinion letters on section 4062(e).

Background

Under the statute, a section 4062(e) event occurs when an employer ceases operations at a facility and as a result, more than 20 percent of the employees who are participants under a plan established and maintained by the employer are separated from employment. Notice of a section 4062(e) event is due within 60 days after the cessation of operations. A section 4062(e) event gives rise to potential liability in the form of an escrow payment to PBGC or a bond. The amount of the escrow payment is a percentage of the liability that would have arisen if the plan had terminated on the date the facility ceased operations, i.e., the difference between the fair market value of plan assets and plan liabilities -- calculated using PBGC termination assumptions -- as of the date of the cessation. The bond may be up to 150 percent of this amount. If the pension plan does not terminate during the five year period following the section 4062(e) event, PBGC returns the escrowed payment (without interest) or the bond is cancelled. If the plan terminates during that period, the amount is used toward the payment of termination liability, if any.

Because the escrow payment bears no interest and the bond can be expensive, PBGC typically uses the threat of these requirements to extract a commitment from the plan sponsor to fund the plan above the level required by PPA.

PBGC issued an amendment to its section 4062 regulation in 2006 that clarified the formula for calculating the amount of the escrow or bond required when a section 4062(e) event occurs. 29 C.F.R. § 4062.8. The 2006 regulation amendment did not, however, provide guidance on determining whether 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 were participants under a plan established and maintained by him are separated from employment." The proposed regulation fills that gap – and more.

Terms of Proposed Regulation

The proposed regulation seems calculated to enhance PBGC's leverage in a section 4062(e) negotiation by broadly defining the "4062(e) event" but giving PBGC discretion to negotiate an arrangement that may be unrelated to the remedy prescribed for section 4062(e), that is, to provide protection in the event the plan terminates during the five years following the 4062(e) event. Under the proposed regulation, section 4062(e) events would occur more

frequently than they occur under previous PBGC opinion letter guidance, thereby increasing the PBGC's leverage to negotiate additional contributions and other "protections" from many more sponsors of ongoing pension plans.

Requirements for 4062(e) Event

Employer "ceases operations at a facility in any location"

Under the proposed regulation, a 4062(e) event requires not that the employer "cease operations" at a facility, as stated in section 4062(e), but merely that an employer cease "an operation" at a facility. Proposed 29 C.F.R. § 4062.23. By substituting the term "operation" for the plural term "operations" found in the statute, PBGC greatly expands the reach of the provision. Section 4062(e) had previously been widely understood to be triggered only if an employer closed a plant and ceased to perform the work performed at that plant (perhaps reflecting congressional concern that such a plant closing could be the first step in a piecemeal liquidation). An "operation" is defined in the proposed regulation as a "set of activities that constitutes an organizationally, operationally, or functionally distinct unit of an employer." Proposed 29 C.F.R. § 4062.24. Significantly, a facility may be associated with more than one operation. Proposed 29 C.F.R. § 4062.25. Thus, under the proposed regulation, an employer satisfies an element of the 4062(e) event when it ceases one but not all distinct types of activities at a facility. For example, an employer that performed manufacturing, shipping, and administrative operations at a facility could meet this standard if it ceased only the shipping operation at the facility.

Moreover, an operation at a facility ceases under the proposed regulation regardless of whether the employer continues or resumes the operation at another facility or begins a new operation at the same facility. Proposed 29 C.F.R. § 4062.26(c). For example (contrary to past PBGC guidance), a mere relocation of an operation from one facility to another constitutes a cessation of operations at a facility in any location. Proposed 29 C.F.R. § 4062.26(c)(1)(i). Compare PBGC Opin. Ltr. 77-134 (March 8, 1977).

Further, the sale of a facility to an unrelated employer constitutes an employer's cessation of operations at a facility, even if the purchaser pays fair value and continues the operations. Proposed 29 C.F.R. § 4062.26(c)(1)(ii). Compare PBGC Opinion Ltrs. 76-52 (April 14, 1976) (4062(e) does not apply to sale of facility resulting in 20% reduction of active participants in the plan where buyer continues operations at the facility and employs substantially all of seller's employees); 86-13 (May 29, 1986) (4062(e) does not apply to the spin off of corporate divisions and related plan assets to a widely held, publicly traded corporation that which will continue to operate assets and maintain plan, and which causes a reduction in active participants from 2,532 to 1,038).

Cessation date

An employer voluntarily ceases an operation at a facility, under the proposed regulation, when it discontinues all significant activity at the facility in furtherance of the purpose of the operation. Proposed 29 C.F.R. § 4062.26(a). For example, for a manufacturing operation, continued processing of materials on hand typically would be significant activity in furtherance

of the purpose of the operation, while sale of leftover inventory typically would not be. Similarly, continuing maintenance and security activities at the manufacturing operation would not further the purpose of the operation.

Where a cessation is "involuntary," that is, caused by events outside the employer's control, such as a strike or a natural disaster, the cessation date would be delayed, but only slightly, to permit the employer to resume activities. In the case of a cessation caused by employee action, e.g., a strike, the employer would have one week to resume the operation before a "cessation" would occur. Proposed 29 C.F.R. § 4062.26(b)(1). Where the cessation was caused by a sudden and unanticipated event other than an employee action, e.g., a flood, the employer would have 30 days in which to resume the operation or trigger a cessation. Proposed 29 C.F.R. § 4062.26(b)(2).

"As a result of such cessation," more than 20 percent of employees "who are participants under a plan established and maintained" by the employer "are separated from employment"

A 4062(e) event requires that, as the result of the cessation of operations at a facility, more than 20 percent of the employees who are participants under a plan established and maintained by the employer are separated from employment.

PBGC reads "established *and* maintained" in section 4062(e) to mean "established *or* maintained" for purposes of the proposed regulation. Preamble at 48284. This interpretation would eliminate the argument that an employer that maintains the plan but did not establish it is not subject to section 4062(e).

Under the proposed regulation, "separated from employment" means separated from service with the employer that ceased the operation. Proposed 29 C.F.R. § 4062.27. It does not mean separated from employment at the operation. For example, an employee who is transferred to another operation of the employer at another facility is not separated from employment as a result of the cessation of an operation. However, as noted, an employee who continues to work in the same operation after it is sold to an unrelated employer is separated from employment as a result of the cessation of an operation.

A separation from employment results from the cessation of an operation if the separation would not have occurred when it did if the cessation had not occurred. Proposed 29 C.F.R. § 4062.28(a). Accordingly, an employee who had already decided to retire on a date that coincides with the cessation of an operation does not separate from employment as a result of the cessation. In contrast, an employee who decides to retire on a particular date because of the cessation of an operation separates from service as a result of the cessation. Whether the separation occurred before or after the cessation date, whether the employee was employed in the operation that ceased, and whether the employee was employed at the facility associated with operation that ceased are not dispositive of whether the separation of employment resulted from the cessation of an operation at a facility. Proposed 29 C.F.R. § 4062.28(b).

The proposed regulation also establishes four presumptions for determining whether a separation from employment results from a cessation of an operation. Proposed 29 C.F.R.

§ 4062.28(c)-(f). Significantly, each of these presumptions is weighted toward increasing the number of employees who are separated from service as a result of the cessation of the operation. Under the presumptions, a separation from employment is presumed to result from the voluntary cessation of an operation --

- If an employee involuntarily separates from employment on or after the date the employer decides to cease the operation at the facility or
- If an employee voluntarily separates from employment after the decision to cease the operation becomes known to the employee, employees generally, or the public.

Proposed 29 C.F.R. § 4062.28(c), (d).

A separation from employment is presumed to result from the involuntary cessation of an operation --

- If an employee voluntarily or involuntarily separates from employment after the date of the event that caused the cessation or
- If an employee becomes employed by a new employer that continues or resumes the operation.

Proposed 29 C.F.R. § 4062.28(e), (f).

To determine whether the number of employees who separate from service equal or exceed 20 percent, the number of separated employees is compared to the number of employees in the plan on the date immediately before the cessation. Proposed 29 C.F.R. § 4062.29(a). While PBGC reads "operations" in the statute to mean "operation" under the proposed regulation, PBGC interprets the word "plan" to mean a single plan, as written in the statute. Accordingly, for a voluntary cessation, the number of active participants in the plan would be counted as of the date immediately before the employer's decision to cease the operation. Proposed 29 C.F.R. § 4062.29(b)(1). For an involuntary cessation, the number of active participants would be counted as of the date immediately before the date of the event that caused the cessation, e.g., strike, natural disaster. Proposed 29 C.F.R. § 4062.29(b)(2).

In determining whether the 20 percent threshold has been met and the due date for reporting, employees who separated from service but were not employed at the facility where the operation ceased need not be counted, unless requested by PBGC. Proposed 29 C.F.R. § 4062.31(g).

Reporting and Enforcement

A 4062(e) event is treated as a withdrawal of a substantial employer to which the provisions of sections 4063 through 4065 apply. Section 4063(a) requires such an employer to notify PBGC within 60 days after the withdrawal. PBGC generally, and in the proposed regulation, applies this 60-day notice requirement to the occurrence of a section 4062(e) event. Proposed 29 C.F.R. § 4062.31(b)(1). The 60 days would run from the later of the cessation date or the date that the number of active participants separated from employment as a result of the

cessation exceeded 20 percent. *Id.* Failure to comply with the reporting requirement could trigger penalties of up to \$1,100 per day under section 4071 of ERISA. Significantly, the preamble to the proposed regulation indicates that PBGC would consider the failure to report a section 4062(e) event as an event that could result in substantial harm to participants and PBGC, warranting the application of penalties greater than the \$25 per day for the first 90 days and \$50 per day thereafter that PBGC generally applies under section 4071.

As noted above, PBGC rarely, if ever, has enforced the escrow or bond requirement described for a section 4062(e) event. Instead, PBGC uses the section 4062(e) event as leverage to negotiate contributions greater than otherwise required by law and/or other protections, such as security, to bolster collection of contributions. The proposed regulation indicates that PBGC intends to continue this practice. While the risk to the plan is not relevant to determining whether a section 4062(e) event has occurred, PBGC may take an employer's financial strength into account in negotiating terms to satisfy the requirements of section 4062(e). Proposed 29 C.F.R. § 4062.23(b). For example, where a new, financially sound employer continues an operation at a facility, and employs the employees of the original employer, PBGC may consider the new employer's adoption of the first employer's plan, or portion of the plan, as a means of satisfying section 4062(e). Proposed 29 C.F.R. § 4062.33(b)(2). Further, PBGC could, under the proposed regulation, waive any provision of the regulation to accommodate the facts and circumstances of particular cases and to "promote the equitable and rational interpretation and application of title IV." Proposed 29 C.F.R. § 4062.35.

The proposed regulation will become effective with respect to 4062(e) events that occur on or after the regulation's effective date. Comments on the proposed regulation are due on or before October 12, 2010.

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We look forward to speaking with you on September 9. If you have questions you would like to ask before that date, feel free to call or email any of the attorneys listed below.

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