

If you have questions, please contact your regular Groom attorney or one of the attorneys listed below:

Mark Carolan
mcarolan@groom.com
(202) 861-5424

Elizabeth Dold
edold@groom.com
(202) 861-5406

Michael Kreps
mkreps@groom.com
(202) 861-5415

David Levine
dlevine@groom.com
(202) 861-5436

Mark Lofgren
mlofgren@groom.com
(202) 861-6614

Louis Mazawey
lmazawey@groom.com
(202) 861-6608

David Powell
dpowell@groom.com
(202) 861-6600

Joshua Shapiro
jshapiro@groom.com
(202) 861-2613

Brigen Winters
bwinters@groom.com
(202) 861-6618

Jeff Witt
jwitt@groom.com
(202) 861-6651

J. Rose Zaklad
rzaklad@groom.com
(202) 861-6626

PBGC Staff Claims Transactions That Reduce Premiums May Be Improper “Form Over Substance”

On July 25, 2018, the Pension Benefit Guaranty Corporation staff (“PBGC Staff”) posted an interpretation on the PBGC’s website in the Premium Q&A’s addressing its position on how PBGC premiums would be determined under a two-step spinoff and termination transaction (<https://www.pbgc.gov/prac/staff-responses-prac-questions> (under the header for “Premiums”). The interpretation reflects the view of PBGC Staff and is not a rule, regulation, or statement of the PBGC. The PBGC Staff describes this two-step transaction as:

Step 1: A spinoff of most plan participants into a new plan late in the year into a new plan that is virtually identical to the old plan, but with a new name, EIN, and plan number, leaving only a small group of retirees in the original plan.

Step 2: The small group remaining in the original plan is terminated (*i.e.* annuities are purchased for the remaining retirees).

The interpretation asserts that the transaction would generate substantial reductions in PBGC premiums under the current PBGC regulations. Under these regulations (29 C.F.R. section 4006): (1) a defined benefit plan is exempt from PBGC variable rate premiums in its final year (*i.e.* the original plan that is terminated), and (2) total PBGC premiums are pro-rated in the first year for new plans (*i.e.* the spun off “new” plan). As a result, over 90% of a plan’s variable rate premium for the year might be eliminated under the transaction.

PBGC Staff noted that the special premium reduction rules in 29 C.F.R. section 4006 were adopted because it seemed overly burdensome to charge a plan an entire year’s premium in a year when one of these one-time events took place (*i.e.* plan termination or plan inception). PBGC Staff is concerned with applying the same rules to the transaction because the vast majority of the participants are covered by PBGC for the full year of the transaction, but, due to the two-step structure, the majority of participants’ benefits have not been fully funded or paid in full.

PBGC Staff expressed concern that the transaction would implicate a federal common law doctrine that looks to “the substance and not the form of a transaction,” and suggested that the transaction, and similar types of transactions, “should be disregarded and premiums assessed as if such transaction had not occurred.” Further, PBGC Staff noted that they were “especially skeptical of this strategy because it seems plausible that some plans could engage in [the transaction] year after year.”

Action Steps

Even though it is not formal guidance from the PBGC, this interpretation will undoubtedly hamper these types of strategies going forward. It is not yet clear whether PBGC will undertake an enforcement initiative in this area or propose a change in its regulations. In the meantime, plan sponsors actively engaged (or previously engaged) in this or similar

transactions should understand the risks and evaluate their next steps. We recommend that plan sponsors consider the ramifications of a PBGC challenge to a transaction, taking into account whether the transaction has been substantially completed or is merely under consideration.

We are actively considering how to approach and address this interpretation for a number of clients. Because each situation varies, please feel free to contact your Groom attorney to discuss options that may be available to you.