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BENEFITS BRIEF

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Major Changes in "Shutdown" Liability under ERISA Section 4062(e)

President Barack Obama signed into law on December 17, 2014 a major bipartisan appropriations bill that included an overhaul of ERISA section 4062(e), which governs an employer's obligations in the event of a cessation of operations at a facility.

<u>Old section 4062(e)</u>

Under the old law, an employer was required to post security with PBGC for five years when an employer with a single-employer pension plan covered by Title IV of ERISA ceased operations at a facility and, as a result of the cessation, 20 percent or more of employees covered by the pension plan were separated from employment. Although this provision went largely unenforced for years, PBGC had more recently adopted an expansive enforcement policy, requiring onerous terms from employers to settle the obligation. PBGC's enforcement of ERISA section 4062(e) drew heavy criticism from the business community. On July 8, 2014, PBGC issued a moratorium on enforcement of 4062(e) through the end of the year.

<u>New section 4062(e)--Events that trigger liability</u>

Under the new ERISA section 4062(e), liability arises when a "substantial cessation of operations" occurs, meaning that operations at a facility permanently cease, resulting in a workforce reduction of more than 15 percent of "eligible employees." The term "eligible employees" is defined as employees eligible to participate in a pension benefit plan of the employer. This is a change from the old law, which only considered a reduction in employees actually covered (not simply eligible to be covered) by the defined benefit pension plan. Under the old provision, an employer with a defined benefit plan frozen to new participants could exceed the 20 percent threshold, even though most employees (covered by a different pension plan) did not separate from employment. So while the new provision reduces the triggering percentage from 20 percent to 15 percent, the group that the percentage applies to will likely be larger.

An eligible employee is counted as part of a "workforce reduction" if he or she is separated from employment because of the employer's permanent cessation of operations at the facility. There is a 3-year look-back period that will include earlier separations that are related to the permanent cessation (i.e., what PBGC calls a "rolling shutdown"). There are several clarifications, however, as to separations that do not count in a "workforce reduction" calculation.

First, an employee who is separated from employment is not counted in the "workforce reduction" if the employee is replaced (within a reasonable period of time) by another employee at the same or different facility. In other words, relocating operations to another facility will not, in and of itself, give rise to liability under ERISA section 4062(e). Second, an employee separated from employment as a result of a sale or other disposition of the employer's assets will not count in a "workforce reduction" calculation if another employer continues the operations, replaces (within a reasonable period of time) the separated employee *and*, if the separated employee was a participant in a pension plan, maintains (again, within a reasonable period of time) a pension plan which includes the assets and liabilities attributable to the accrued benefit of the separated employee. Third, the separated employee is not counted in a "workforce reduction" calculation if the employee continues to be employed by the new employer *and* is either not a participant in a pension plan sponsored by the old employer or, if he or she is a participant in a pension plan, the new employer maintains (within a reasonable period of time) a pension plan which includes the assets and liabilities attributable to the accrued benefit of the employee.

The new section 4062(e) also is more limited in scope, as it does not apply to employers that sponsor plans with fewer than 100 participants or that are at least 90 percent funded, calculated on the same basis as is required for the purposes of determining PBGC premium payments.

Option to Make Additional Contributions

Under the prior law, PBGC typically settled an employer's obligation to provide security to PBGC under ERISA section 4063 by an agreement, for example, to make additional contributions to the pension plan or to provide alternative security over a 5-year period. The amount of the additional contributions or security was based on the unfunded benefit liability of the plan determined as if the plan had terminated on the date of the cessation of operations using PBGC's conservative termination assumptions. Under the revised provision, employers may elect to satisfy the liability by making additional contributions to the plan over the 7-year period following the cessation of operations. Further, the amount of the additional contributions is determined using the plan's unfunded vested benefits for variable rate termination purposes. In many cases, this amount will be significantly lower than the unfunded benefit liabilities on a termination basis.

The amount of each additional contribution is calculated by multiplying $1/7^{th}$ of the unfunded vested benefits (as determined under ERISA section 4006(a)(3)(E)) by the "reduction fraction," which is, with respect to a pension plan, the number of participants with accrued benefits who are counted in the "workforce reduction" calculation, divided by the total number of eligible employees of the employer who are plan participants. The amount of each additional contribution is limited to the excess of (1) 25 percent of the plan's underfunding (calculated on an ongoing, rather than termination, basis), over (2) the minimum required contribution for the plan year.

These contributions are in addition to the minimum required contributions under ERISA section 303, i.e., the additional contributions cannot create a prefunding balance. The requirement to make additional contributions ceases when the plan becomes at least 90 percent funded, or if the Treasury issues a funding waiver with respect to the pension plan. If an employer fails to pay any additional contribution, the entire amount of the remaining additional contributions comes due to the plan.

An employer electing to make additional contributions to satisfy the liability under section 4062(e) must inform PBGC of its election within 30 days after it notifies PBGC of the substantial cessation of operations, or within 30 days after PBGC determines that a substantial cessation of operations has occurred.

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Continued and New Concerns

While the new section 4062(e) addresses many of the business community's concerns under the old law, several issues remain. For example, the new law does not clarify whether PBGC can file a lien under ERISA section 4068 in connection with unpaid liability under section 4062(e). Moreover, the requirement that an employer take certain actions "within a reasonable period of time"—e.g., replace separated employees or maintain a pension plan that includes an employees accrued benefit—exposes employers to uncertainty regarding PBGC's interpretation of that language in any given case.

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