

**American Bar Association
Joint Committee On Employee Benefits
Q&A Session With The PBGC
May 17, 1995**

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I. Retirement Protection Act

1. Notice of Underfunding

Will Section 4011 be enforced if a regulatory moratorium is imposed prior to the issuance of final regulations?

Answer:

If a moratorium is enacted prior to the issuance of final regulations under Section 4011, the PBGC will honor it.

2. Notice of Underfunding

Under Prop. Reg. §2627.9(d), interpreting Section 4011, the “plan administrator may include in the Participant Notice any other information not required by [the regulations] only if it is in a separate document.”

- (a) It remains unclear what this language means; specifically, what the proposed regulations mean by "other information." Does this mean factual information only, so that plan sponsor opinion, comment and interpretation would be permitted, or do the regulations mean that all other language is prohibited? If the latter is intended, statements to the effect that the model notice is an "example" of what is permitted should probably be eliminated, because the use of the model is in effect being required. The quoted sentence is also somewhat unintelligible, since it remains unclear how one can include any information "in" a participant notice if it is in a separate document.
- (b) It seems unlikely that the exclusion of "any" other information was intended. For example, there is no requirement that a plan sponsor give a date as of which the Notice of Funding Percentage is calculated. Does this mean that the plan sponsor cannot properly identify the date as being the date other than the current one?
- (c) What is a separate document for this purpose? Plan sponsors will surely be interested in distributing a cover page to the mandated notice, even if not actually stapled to the Notice. It remains unclear whether a document distributed at the same time that refers to the Notice will be considered a "separate document." It would seem more appropriate to focus on whether the participant is confused or misled by additional information, rather than whether or not the additional information is in a separate document.

Answer:

PBGC responded to the three subparts of this question together. PBGC is working as quickly as it can to finalize the proposed regulations under ERISA section 4011, and expects to provide final regulations in 1995. In the proposed regulations, the agency tried to ensure that the notice would not be cluttered with distracting information. Final regulations are likely to contain the requirement (as stated in the proposed regulations) that extra information must be in a "separate document." It is also likely that the topics for disclosure identified in the proposed regulations will be clarified and perhaps additional latitude will be given to plan sponsors with regard to these topics. For example, sponsors will probably be allowed to identify the date as of which the notice funding percentages is determined. It is possible that final regulations will allow electronic transmission of the notice to those participants who can be reached electronically. The agency expressed disappointment that no comments were received on mergers and acquisitions. No additional detail was provided on what is a "separate document."

3. Notice of Underfunding

Prop. Reg. §2627.9(b)(5), interpreting Section 4011, says that "if the plan has not received the minimum required contribution required under ERISA Section 302 for any prior plan

year, a statement identifying each such plan year” must be made in the Notice. The model Notice and the literal language of Prop. Reg. §2627.9(b)(5) could suggest that a plan sponsor must disclose any plan year in which the minimum required contribution was not received, not just those years for which there are unpaid outstanding minimum contributions. Could the agency supply more detail as to what is meant?

Answer:

The PBGC is reviewing this issue and intends to address it in final regulations.

4. Reportable Events

Q&A 2 of Technical Update 95-3 states the PBGC will not apply a penalty for failure to satisfy the new reportable event requirement if (1) a plan is fully funded, and (2) the notice is due after the event.

Under Q&A 2 of Technical Update 95-3, do *all* of the plans in a controlled group have to be fully funded to escape penalty?

Answer:

To avoid the penalty, all of the plans in the controlled group must be fully funded. However, the PBGC noted that there may be circumstances in which penalties may not be warranted, e.g., where a plan is spun-off from a fully-funded plan.

5. Reportable Events

Will regulations provide greater relief than under Technical Update 95-3?

Answer:

The PBGC gave no answer to this question.

6. Reportable Events

Does the PBGC require reportable event notices where transactions involve (a) the foreign parent of the U.S. plan sponsor, or (b) the foreign subsidiary of the U.S. plan sponsor?

Answer:

Yes, in both cases. The law does not exempt reports relating to foreign entities.

Follow-up question:

In the case of a U.S. subsidiary of a foreign parent, the U.S. subsidiary will not have any knowledge about transactions occurring overseas. Is there any way they can relief from the PBGC?

Follow-up answer:

The law is clear that these are reportable events. The only way PBGC can waive the filing requirement is through regulations. The PBGC can, however, waive penalties for noncompliance without regulations.

7. Reportable Events

New Section 4043(c)(11) requires notice to PBGC of certain redemptions of 10 percent or more of the voting power of all classes of stock entitled to vote or of the value of all shares of stock of a contributing sponsor and all members of its controlled group.

- (a) Is notice required if a subsidiary redeems 10 percent of its stock from its parent? Should such stock value be measured against the entire controlled group?
- (b) Where stock value is determined by reference to voting power, how is the 10 percent determination made for a wholly-owned subsidiary?

Answer:

The PBGC was not able to give definitive answers to these questions. They are in the process of thinking through a great number of issues dealing with reportable events.

8. Missing Participants

When does the PBGC anticipate issuing guidance under §4050 concerning PBGC procedures for missing participants, and how will the program be structured?

Answer:

The PBGC hopes to issue a proposed regulation in June. The final regulation is expected to cover distributions occurring after 1995. The program is likely to require that the sponsor make a diligent search for a missing participant. Thereafter, the plan can either purchase an annuity on the individual's behalf or transfer funds for his benefit to the PBGC (with information necessary to identify the individual). Pricing issues have yet to be decided. The regulation will not be retroactive, nor it will cover defined contribution plans.

II. Other Title IV Issues

9. PBGC Premiums

PBGC may waive late payment penalties for delinquent premiums based on a "demonstration of good cause." (§2610.8(b)(2))

- (a) In general, what standard does PBGC apply in determining whether "good cause" has been demonstrated?
- (b) If the premium delinquency was due to reasonable reliance on professional advisory, will this satisfy the "good cause" standard?
- (c) Will the PBGC consider coordinating its review standards with the standards currently applied by the IRS and the DOL?
- (d) What office reviews penalty appeals and what are the qualifications of the appeals officers?

Answer:

The PBGC officials responded by answering each of the four parts to this question separately. Initially they stated that we should recognize that the same "good cause" standards cannot be applicable to both large and small employers and that different standards need to be made. In general, they indicated that so far they have limited waivers to situations that are generally not controllable by the plan or the employer. They indicated, for example, that mailings to the wrong address, reasonable delays for events such as earthquakes, fires and storms or particular personal problems that may confront key individuals in small plans have been considered sufficient grounds for waivers. They stressed that this is done on a case-by-case basis.

With respect to reliance on a professional advisor, they indicated that that is also determined on a case-by-case basis. If reliance is made on a professional, it will not automatically provide a sufficient excuse. They indicated that in general they take a more restrictive position on this issue than the Internal Revenue Service.

With respect to coordination with the IRS and the DOL, they indicated that they do not "precisely" coordinate with those agencies but that some coordination does occur. They indicated that they are in the process of considering changes currently and that some coordination of those changes is taking place.

With respect to review procedures and appeals officers, they indicated that these waivers are not covered by their published appeals procedures.

The PBGC officials also indicated that they were in the process of being responsive to a Presidential request that all agencies reconsider their policies with respect to penalties. They stated that the PBGC is in the process of reconsidering its penalty policies pursuant to that request.

In response to a question that was raised about informing the public of the standards they apply, they indicated that the PBGC is considering this in the context of its reconsideration of its penalty policies. They indicated that it is quite possible that they may make the new standards available to the public although they expressed some concern that if they publish acceptable excuses people will automatically claim those excuses whenever a penalty may otherwise be applicable.

10. Benefit Liabilities

Is the class of "nonforfeitable benefits" defined in §4001(a)(8) different from "benefit liabilities" defined in §4001(a)(16)? What are the differences, if any?

Answer:

"Benefit liabilities" includes "nonforfeitable benefits" but has a broader scope. Reference was made to the categories of Section 4044(a): categories 1-5 would be nonforfeitable, but benefit liabilities would include category 6.

11. Benefit Liabilities

In the absence of regulations from the IRS indicating the scope of "benefit liabilities," what guidance has been given to PBGC employees in applying the standard termination requirements?

Answer:

No general guidance has been given to PBGC employees regarding the scope of "benefit liabilities." It has been reasonably clear in practice. There has been consultation with the IRS on some individual cases.

12. Standard Terminations

In PBGC audits of standard terminations, is there any pattern to the problems that PBGC has uncovered in its audits?

Answer:

Frequent problems involved the use of the appropriate interest rate for lump-sum distributions (§417(e)(3)) and the correct valuation date required under the plan document.

13. Waiver of Benefits

The standard termination regulations (§2617.7(b)) provide that a majority owner may "agree to forego receipt of all or part" of his benefits until benefit liabilities of other participants are satisfied, in order to facilitate a standard termination. The preamble to the regulations (57 Fed. Reg. 59211-12) state that, "if assets become available when final distribution occurs such assets must be used to satisfy the benefit liabilities of the majority owner before any assets may revert to the contributing sponsor." This appears to permit a majority owner to waive accrued benefits to achieve a standard termination. Was this approach coordinated with the IRS and do they agree that such a waiver does not violate qualification rules in general, and §411(d)(6) of the Code in particular?

Answer:

This approach was coordinated with the IRS and should be permitted by the Service to enable the PBGC to administer Title IV. The PBGC treats this approach as "an alternative treatment to affect a standard termination," rather than a waiver of benefits.

14. Penalties for Failure to Issue Notices

PBGC is authorized to assess penalties of up to \$1,000 per day for failure to provide "any notice or other material information" required under §4071.

- (a) In what specific instances has the PBGC imposed a penalty?
- (b) If penalties have been assessed, how were these calculated (e.g., what was the daily penalty assessed for each type of notice or other material information that was delinquent)?
- (c) What criteria are applied for such penalties? Does the PBGC take into that account willfulness or intentional disregard is not present?
- (d) Have penalties been assessed if Form 501 (Notice of Distribution of Plan Assets) is delinquent?

Answer:

The PBGC staff noted that it was reviewing the entire penalty area consistent with the President's order. The PBGC staff referred to the PBGC Policy Statement on Assessment of Penalties for Failure to Provide Required Information, published in the March 3, 1992 Federal Register, which was added to the PBGC Operating Policy Manual. The PBGC staff stated that penalties for failure to file a post-distribution certification in a standard termination and for failure to file a notice of reportable event have been assessed. The above-referenced Policy Statement sets forth guidelines for penalties. The Policy Statement provides that a guideline for the penalty for failure to file a post-distribution certification in a standard termination should not exceed the lesser of \$50 per day until the certification is submitted or \$200 times the number of participants entitled to a distribution in the termination. The Policy Statement provides that a guideline for the penalty for failure to file a notice of reportable event would be up to \$1,000 per day with a cap of \$10,000. The RPA reportable events are not covered by the Policy Statement. The criteria applied to penalty assessment are set forth in the Policy Statement: (i) the extent of the failure; (ii) the financial or administrative harm to the PBGC's program; (iii) the willfulness of the failure; and (iv) the likelihood that the penalty will be paid. Most penalties relate to the failure to file a post-distribution certification (PBGC Form 501).

15. Evasion or Avoidance of Liability

During the past year, has the PBGC applied (or threatened to apply) penalties where it alleged that the principal purpose of a transaction was to evade liability under Title IV, where the transaction became effective within five years before a plan termination?

Follow-Up:

Does the PBGC utilize the threat of liability under §4049 to become a "party" in pending corporate transactions in which a plan termination has not been contemplated?

Answer:

During the past year, the PBGC has not applied any penalties under Section 4069 of ERISA. Their preferred method of operating is to negotiate protection for the agency in a Section 4042 distress termination proceeding or otherwise.

While the PBGC has not used the threat of liability under Section 4049 to intervene, it was thought to be a factor in the GM/EDS case in encouraging the parties to the corporate spin-off to come forward and discuss their concerns with the agency.

16. Please describe significant new litigation that PBGC has commenced in the past year that has set (or is likely to set) important precedent and that should be of interest to benefits attorneys who are not professional litigators.

Answer:

New Valley Corporation: A settlement was reached between New Valley Corporation, the PBGC, and First Financial Management Corporation, which will result in First Financial's agreement to assume the liabilities of Western Union Financial Management Service's pension plan. Western Union is a major asset of New Valley. When New Valley filed for bankruptcy in 1991, their pension plan was underfunded by approximately \$400 million. New Valley's business continued to grow under Chapter 11 reorganization. The PBGC then sought to negotiate an agreement which would protect the underfunded pension plan. An agreement was also made with the Creditor's Committee to end the exclusive period of the plan. The PBGC also filed a plan to protect the pension rights of any beneficiaries and participants and to give equity to creditors.

The bankruptcy court held an auction of Western Union, with a few, but not all, of the bidders willing to accept liability for the underfunded plan. The winning bidder, First Financial, proposed to leave the plan behind in a shell corporation. As a result, the PBGC filed suit seeking to terminate the plan, but within one day an agreement was reached requiring First Financial to assume Western's claim liabilities under the plan and meet the plan's minimum funding requirements. This case is reminiscent of the LTV Holdings case.

Piggly Wiggly: A judgment was issued against Piggly Wiggly Supermarkets in United States District Court for the Northern District of Alabama on April 4, 1995, which will force Piggly Wiggly to supply more than \$1 Million to a terminated pension plan. An audit of the terminated plan revealed to the PBGC that the plan benefits were undervalued at the time of the termination. The dispute centers on §417 of the Internal Revenue Code and the correct method of determining the interest rate on the date of termination. The PBGC contends that an immediate interest rate was used when a deferred or graduated interest rate should have been used. The Court accepted the PBGC's determination of the interest rate, resulting in the award of additional benefits. Piggly Wiggly has appealed this decision to the 11th Circuit Court of Appeals.

United Engineering: In a May 2, 1995, decision by the United States Court of Appeals for the Sixth Circuit, it was held that suits by employees against employers under §301 of the Labor Management Relations Act seeking to recover nonguaranteed benefits from terminated pension plans are precluded. Since the 1986 (SEPPAA) and 1987 (PPA) amendments to ERISA, the PBGC has been required to allocate nonguaranteed benefits according to a priority scheme (§4022(c)). It was the PBGC's contention that the amendments to ERISA filled gaps as to the allocation of nonguaranteed benefits and would eliminate the need for federal common law which originally served to fill the gap. This federal common law allowed the employee to bring an action against an employer for the

nonguaranteed benefits [Murphy v. Heppenstall Co., 635 F.2d 233 (3rd Cir. 1980)] under §301 of LMRA.

The Court relied on a line of environmental cases [Illinois v. City of Milwaukee, 406 U.S. 91 (1972) and City of Milwaukee v. Illinois, 451 U.S. 304(1981)] which determined the need for reliance on federal common law to be displaced when Congress addresses a question originally addressed by common law. Both SEPPA and PPA were Congressional actions designed to fill the gaps and mandate the allocation of nonguaranteed benefits. In addition the Court relied on a decision by the District Court for the Western District of Oklahoma, In re Adams Hard Facing Co., 129 B.R. 662 (W.D. Okla. 1991), which determined that employee's could not recover benefits from a pension plan directly from the employer's bankruptcy estate. The Court also relied on a decision from the Northern District of New York which held that employees could not maintain an action against their employer to cover plan benefits that were to be distributed by the PBGC according to the now replaced SEPPAA. International Association of Machinists & Aerospace Workers v. Rome Cable Corp., 810 F. Supp. 402 (N.D.N.Y. 1993). The Court also considered the chance for a double recovery by an employee against the employer and the PBGC in its order to affirm the district court's decision to not allow an employee the right to sue an employer directly for nonguaranteed benefits of a terminated pension plan.

Armco, Incorporated: The PBGC filed suit against Armco, Inc. in the United States District Court for the District of Minnesota, Pension Benefit Guaranty Corporation v. Armco, Inc., No. 3:94 Civil 326, seeking to hold Armco liable for approximately \$21.4 Million of underfunding of a pension plan held by a corporate affiliate, Reserve Mining Company.

First Taconite, Inc. is a corporation owned by Armco which held a 50% ownership in Reserve Mining. Reserve Mining and its partners filed bankruptcy and sought distress termination of the underfunded pension plan. The PBGC settled its claims against Reserve Mining, but had to withdraw its claims against First Taconite because its only asset was Reserve Mining. The PBGC then brought suit against Armco seeking to establish liability for the underfunding of the Reserve Mining plan. The PBGC based Armco's liability on a 1991 decision by the Eight Circuit Court of Appeals which determined that Armco and First Taconite were corporate alter egos (Minnesota Power v. Armco, Inc., 937 F.2d 1363).

Armco and the PBGC have since entered into a settlement giving the PBGC \$10 Million for the underfunded guaranteed benefits of the Reserve Mining plan and allocating \$17.5 Million to Armco's own plan. In a subsequent action, the trustee of a trust established pursuant to §4049 of ERISA has asserted claims against Armco seeking the nonguaranteed plan benefits, Reich v. Armco, Inc., (3-94 Civil 927). In a March 28, 1995, order the District Court for the District of Minnesota denied Armco's motion for summary judgment in the matter. The case is still pending in the Eighth Circuit Court of Appeals.

CF&I Steel Corporation: In November of 1990 CF&I Steel Corporation filed for bankruptcy. The PBGC then involuntarily terminated CF&I's largest pension fund, which was underfunded by approximately \$220 Million. The PBGC sought to have its claims, seeking minimum contributions to the fund by CF&I, entitled to priority status as post-petition taxes [§507(a)(7) of the Bankruptcy Code]. The United States District Court for the District of Utah stated that the PBGC's priority claim would only apply to debts underlying claims incurred subsequent to CF&I's filing of bankruptcy. The Court held that CF&I's debts were incurred through the performance of labor prior to the filing of the petition, and not subsequent. The PBGC unsuccessfully argued the debts were incurred when the quarterly funding requirements came due, after the petition was filed.

The District Court also considered whether the PBGC's use of a discount rate was correct when calculating the actuarial present value of guaranteed benefits. The Court found the use of the PBGC regulation calling not applicable, but yet have it due deference in the formulation of a reasonable calculation of the interest. CF&I contends that the discount rate should be determined according to bankruptcy law. A cross-appeal ensued on this issue. A decision by the United States District Court for the District of Utah resulted in the priority claim issue being affirmed and the discount rate issue being remanded with no due deference being given to the PBGC's regulation methodology. Pension Benefit Guaranty Corporation v. Reorganized CF&I Fabricators of Utah, Inc., 179 B.R. 704 (D.Utah 1994).

White Consolidated Industries: White Consolidated Industries sold several steel companies to Blaw Knox Corporation in 1985. A portion of the agreement called for White to continue substantial annual contributions to the nine underfunded pension plans which were also acquired by Blaw Knox until 1990.

White made all of its contributions until 1990, and shortly thereafter the plans ran out of assets. The PBGC then sought to terminate the plans which were now underfunded by approximately \$102 Million. The PBGC claimed that White still maintained liability for the plans because the plans were sold to avoid plan liability (ERISA §4069) A decision by the Third Circuit Court of Appeals, 998 F.2d 1192 (3rd Cir. 1993), reversed a district court decision dismissing PBGC's claim that White was liable for the underfunding of the plans. The Court of Appeals held that under ERISA §4069 a transaction will not become effective until the transferor of the pension plan no longer makes substantial contributions to the plan. The five-year period will then take effect and if the plan is terminated within 5 years of the transaction becoming effective, the transferor will still be liable for the plan. This will eliminate the opportunity for a company to avoid plan liability by transferring it to another who is incapable of supporting the plan and ensuring that payments will be made for only the statutory 5 year limit. The transfer will not become effective until the transferee is able to support the plan payments on its own.

The Court also reversed the District Court's decision to dismiss a claim by the PBGC stating White's only motivation for the transfer to Blaw Knox was to avoid pension liabilities and a sham transaction. The Circuit Court affirmed the dismissal of a claim by the PBGC under ERISA §4062 mandating an implied termination if a plan is transferred to

an undercapitalized entity. The Court declined to read predecessor liability into §4062. The Court also affirmed the dismissal of a claim by the PBGC alleging each post-sale contribution by White constituted a separate transaction by White to avoid liability. The Court held the contributions were part of the fulfillment of fixed contractual obligations and not separate transactions.

The Supreme Court denied certiorari in 1995 (114 S.Ct. 687). However, a counter-claim filed by White alleging that White was misled by the PBGC into making the deal with Blaw Knox is currently still pending.