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abiLIVE webinar series

IMPORTANT PENSION ISSUES LIKELY TO SURFACE

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PROVINCE

THE WAGNER LAW GROUP

PENSION BENEFIT GUARANTY CORPORATION

- The Pension Benefit Guaranty Corporation ("PBGC") is a wholly owned US Government corporation created under Title IV of ERISA.
- Modeled after the FDIC, PBGC pays guaranteed benefits of terminated defined benefit pension plans subject to statutory limits.
- PBGC insures: (i) single employer defined benefit pension plans, and (ii) multiemployer defined benefit pension plans.

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SINGLE-EMPLOYER DEFINED BENEFIT PENSION PLANS

- What is a defined benefit plan?
- Defined benefit plan funding requirements
- PBGC premiums and reporting requirements

DETERMINATION OF MINIMUM FUNDING OF SINGLE-EMPLOYER PLAN

- Each year, the shortfall and normal cost are calculated.
  - The shortfall is the difference between benefit liabilities and plan assets.
  - Normal cost represents current year accruals.
  - The present value of benefit liabilities is based on interest rates reflecting the yield curve for investment-grade bonds of maturities matching the periods the benefits are payable.
- A pre-funding or carryover balance may be used to offset future contributions.
- Until recently, the shortfall was amortized over seven years. Under 2021 amendments, the shortfall is amortized over fifteen years.

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MULTIEMPLOYER DEFINED BENEFIT PENSION PLANS

- What is a multiemployer plan?
- Funding and contractual contribution obligations
- Withdrawal liability
- Multiemployer plans as creditors in bankruptcy
- Rehabilitation plans and special financial assistance

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PENSION PLAN TERMINATIONS

- Under ERISA, a single-employer pension plan may be terminated in 3 ways:
  - standard termination, initiated by the plan sponsor
  - distress termination, initiated by the plan sponsor
  - involuntary termination, initiated by PBGC
- For a standard termination, a pension plan must have assets sufficient to fund all benefit liabilities.
- For a distress termination, the plan must be unaffordable.
- For an involuntary termination, grounds include a funding default or increased risk to PBGC
  - PBGC may initiate a proceeding to terminate a pension plan without violating the automatic stay in bankruptcy.

CLAIMS THAT ARISE ON TERMINATION OF AN UNDERFUNDED SINGLE-EMPLOYER PLAN

- Upon the termination of a pension plan, the plan sponsor and controlled group are in general subject to four types of claims
  - Missed minimum funding claim
  - Unfunded benefit liabilities claim
  - Premium claim, including termination premium
  - Excise tax claim

THE CONTROLLED GROUP RULE

- Typically, the "Controlled Group" includes the plan sponsor and all chains of 80% owned subsidiaries (whether directly or indirectly owned); it would also include any 80% parent, and any other chains of 80% owned subsidiaries of the common parent. *See* 29 U.S.C. § 1301(a)(14).
- Private equity fund as a controlled group member. *See Sun Capital Partners III v. New England Teamsters & Trucking Indus Pension Fund*, 724 F.3d 129 (1st Cir. 2013), *on remand*, 172 F. Supp. 3d 447 (D. Mass. 2016), *rev'd*, 943 F.3d 49 (1st Cir. 2019).
- PBGC claims against non-debtors.

PBGC UNSECURED CLAIMS IN BANKRUPTCY

- In most bankruptcy cases, PBGC files the following 3 unsecured claims:
  - unfunded benefit liabilities, calculated based on PBGC funding regulation
  - missed minimum funding contributions, filed on behalf of the pension plan
  - unpaid premiums, including termination premiums.
- If the plan has not yet terminated, PBGC's claims (other than annual premiums) are contingent upon Plan termination.

PBGC SECURED CLAIMS

- PBGC may assert the following 3 secured claims in a bankruptcy:
    1. IRC section 430(k) lien for missed minimum funding contributions.
    2. ERISA section 1368 lien upon plan termination, limited to 30% of the collective net worth of the plan sponsor and controlled group.
    3. Consensual lien.
- PBGC's statutory liens have the status of "taxes due and owing the United States" 26 U.S.C. § 430(k)(4)(C); 29 U.S.C. § 1368(c)(2).

DISTRESS TERMINATION OF SINGLE-EMPLOYER PLAN IN BANKRUPTCY

- Plan sponsor and each member of controlled group must demonstrate they are in financial distress
- Grounds for Distress Termination in bankruptcy
  - Liquidation Test
  - Reorganization Test
- Termination process
  - Select Date of Proposed Termination
  - Issue Notice of Intent to Terminate
  - File Distress Termination Notice with PBGC

DISTRESS TERMINATION OF SINGLE-EMPLOYER PLAN IN BANKRUPTCY

- Distress termination in bankruptcy, the bankruptcy court must make a finding that:
  - unless the plan is terminated, the debtor and each of its subsidiaries would be unable to pay their debts pursuant to a plan of reorganization or would be unable to continue in business outside of Chapter 11.
- Business forecasts, cashflow projections, funding projections
- Diligence by lawyers, financial analysts, actuaries, and other professionals

INVOLUNTARY TERMINATION OF SINGLE-EMPLOYER PLAN IN BANKRUPTCY

- PBGC must show that plan has not met minimum funding standard, that plan will be unable to provide benefits, or that PBGC's long-run risk of loss may increase unreasonably.
  - Minimum funding standard is not met if sponsor fails to make its plan year contribution by 8-1/2 months after close of plan year.
  - A plan will be unable to pay benefits if it is abandoned or unsustainable.
  - In assessing increased risk of loss, PBGC uses bond ratings/cumulative probability of default, as well as business forecasts, cashflow projections, funding projections.
  - Some courts hold that long-run loss criterion governs only PBGC decision to litigate and that PBGC must prove its case by a preponderance of evidence.

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OTHER PREDICTORS OF BUSINESS FAILURE ARE WIDELY ACCEPTED

- Altman's original 1968 Z-Score model is based on 66 public manufacturing firms; 33 bankrupt and 33 nonbankrupt, and a holdout sample of 50 firms, none with more than $25 million assets or liabilities

$$\zeta = 1.2A + 1.4B + 3.3C + 0.6D + 1.0E$$

- Using this model, a $\zeta < 1.81$ indicates a firm in the Distress Zone
- However, due to the deterioration of corporate creditworthiness over the last 50 years, using a 1.8 cutoff may result in as much as 25% of all firms being in the Distress Zone
- Altman suggests instead to use bond-rating equivalents based on the most recent median Z-Scores by bond-rating

TERMINATION LIABILITY FOR SINGLE-EMPLOYER PENSION PLANS

- Prior to termination of a pension plan, the sponsor and all members of the controlled group are required to pay contributions to the pension plan based on an assumption that the Plan is ongoing.
- Upon termination of the pension plan, all liabilities of the pension plan are immediately due. Thus, unfunded benefit liabilities of the pension plan are calculated on a termination basis in according with PBGC's funding regulation. 29 CFR § 4044.41 to 4044.75.

WITHDRAWAL LIABILITY FOR MULTI-EMPLOYER PLAN

- Liability is triggered by complete or partial withdrawal
  - Complete – permanently ceases covered operations or obligation to contribute to a plan under collective bargaining agreement(s)
  - Partial – goes non-union at one but not all operation or has a 70% reduction in covered hours that last three years
  - Employers are required to pay their share of the plan's unfunded benefits based on methods prescribed by law or allowed by the PBGC
  - Presumptive method
  - Modified presumptive method
  - Direct attribution method
  - Rolling Five method
  - New and Old Employer two-pool method

COMMON PENSION ISSUES IN BANKRUPTCY

- Funding under first-day orders
- PBGC, unions, and multiemployer plans as Creditors Committee members
- Section 1113 Rejection of Collective Bargaining Agreements and effect on distress termination and withdrawal
- Section 363 sales

PENSION PLAN ISSUES RELATED TO CHAPTER 11 PLANS

- Whether pension plan continues post-effective date of a Chapter 11 plan.
- Effect of substantive consolidation on joint and several claims
- Termination Premiums
- Releases of non-debtors, including buyers, settling parties, and fiduciaries
- Feasibility of Chapter 11 Plan – Not a guarantee of success but a reasonable assurance.

DEFINED CONTRIBUTION PLANS IN BANKRUPTCY

- Definition – contributions with no fixed benefit
  - Never "underfunded"
  - No PBGC coverage
- Contributions
  - Priority status?
  - Employer match – discretionary or nondiscretionary
- Exemption from estate
- Employer Securities
  - Valuation - efficient market public v independent appraisals
  - Publicly traded – securities law implications
  - Conflict – settlor v fiduciary

DEFINED CONTRIBUTION PLANS IN BANKRUPTCY

- Plan Administration
  - Continue or terminate plan
  - Funding issues, investment issues
  - Abandoned Plan

FIDUCIARY ISSUES IN BANKRUPTCY

- Under section 704 (a)(11) of the Bankruptcy Code, the Chapter 7 Trustee shall continue to perform the obligations required of the administrator of the plan
- Issues may involve:
  - Settlor v Fiduciary conflict
  - Employer securities
  - Unpaid contributions
  - Plan investments
  - Benefit Claims
  - Litigation
  - Personal liability fiduciary

THANK YOU

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Israel Goldowitz is a partner with The Wagner Law Group in Washington, D.C., and has more than 35 years of experience in employee benefits, most notably with mergers and acquisitions, restructuring and bankruptcy as they affect pension plans. As the chief counsel for the Pension Benefit Guaranty Corporation (PBGC), he led the legal teams that helped save the pensions of such companies as Chrysler and American Airlines. Working closely with financial analysts, actuaries and outside advisors, he also led the legal teams that negotiated pension protections with such companies as Sears and Gannett, lending to his unique experience in the mitigation of risks to pensions resulting from corporate transactions, including mergers, acquisitions, secured borrowing and downsizing. Mr. Goldowitz helped establish several key precedents in the U.S. Supreme Court and courts of appeals, including decisions upholding mandatory arbitration of withdrawal liability claims, defining the rules for terminating single-employer plans and for related asset distributions, and confirming the application of ERISA in pension disputes in bankruptcy. He began his career with the United Mine Workers of America Health & Retirement Funds, a pioneering group of multiemployer plans. He was the lead PBGC attorney on multiemployer transactions, rulings and advice for many years, and most recently he oversaw that work as PBGC's deputy general counsel for Program Law and Policy. He has also had charge of several friend-of-court briefs that helped shape the law governing multiemployer plans. While serving as deputy general counsel, Mr. Goldowitz also oversaw the development of regulations and other guidance for the PBGC single-employer and multiemployer insurance programs and advised Congress on legislative proposals affecting those programs. Additionally, he advised on retirement security in general, including new models for improving employee coverage while limiting employer cost and exposure. Mr. Goldowitz is a frequent speaker and has written book chapters, articles and continuing legal education materials on both employee benefits and bankruptcy topics. He is a member of the Board of Governors of the American College of Employee Benefits Counsel and is active in the International Pension and Employee Benefits Lawyers Association. In addition, he served on the Labor and Benefits Advisory Committee to ABI’s Chapter 11 Reform Commission and co-wrote the report of the Pension subcommittee. Mr. Goldowitz has taught in the Georgetown University Law Center LL.M. program since 1991 and is a member of the John Marshall Law School Employee Benefits Advisory Board. He received his B.A. in history from Boston University and his J.D. from George Washington University National Law Center.

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Wilkes has experience in handling audits by the Department of Labor, IRS and SEC. He gives advice and counseling with respect to retirement plan services agreements, investment management agreements, DOL regulations, SEC regulations, federal legislative activity, qualified employee pension plans, ERISA litigation, collective investment funds, offshore investment advisers, sales and marketing distribution agreements and wrap-fee programs. He also has worked closely with his clients regarding structures among broker-dealer firms and platform-provider firms for product distribution and preparing nondiscretionary or discretionary advisory agreements, Form ADV Part 2, regulatory disclosures and filings, marketing materials, prospectus, revenue sharing, best investment-management practices, CIF advisory and subadvisory agreements, selling and administrative services agreements, distribution agreements, vendor agreements, compliance manuals and WSPs. Mr. Wilkes has worked with various parties to chapter 11 bankruptcy proceedings and other financial reorganization and restructuring matters on ERISA, pension plan and related employee benefit matters and claims. Prior to working at The Wagner Law Group, he was an attorney in a San Francisco law firm, senior counsel at Financial Engines, Inc. in Palo Alto, and worked at Merrill Lynch in San Francisco in the fields of ERISA, securities and retirement/compensation services. Additionally, he founded and headed his own firm specializing in the area of ERISA. Mr. Wilkes's experience also includes partner, associate, general counsel and assistant general counsel positions at The LTV Corp. (NYSE) in Cleveland, Merchants Suisse Inc. in New York, Hughes and Luce in Dallas, Winstead, Sechrest & Minick in Dallas and Gordon Hurtwitz in New York. He received his R.I.B.A. in political science from the University of Rhode Island, his M.B.A. from Emory University and his J.D. from Emory University School of Law.