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NATIONAL RETIREE
LEGISLATIVE NETWORK

Pension Plan Risks in Mergers, Acquisitions and Spin-offs

1/15/2021

Executive Summary

Certain corporate transactions – particularly the spin-off of under-performing subsidiaries – greatly increase the risk of a distress termination and the loss of benefits for retirees and other plan participants. Unfortunately, spin-offs can be even more profitable when legacy pension, health and welfare benefits are taken off the books of the parent company. Congress needs to update a number of ERISA provisions to ensure that both pension spin-offs and the merger of plans following M&A activity do not unnecessarily increase the risk of a distress termination and permanent pension losses for plan participants.

The stakes are high for workers and retirees when an under-funded pension plan is terminated or abandoned. Retirees have a common misconception that the Pension Benefit Guaranty Corporation (PBGC) fully guarantees all vested pension benefits. In reality, although most retirees continue to receive their monthly benefit, when an under-funded pension plan terminates it imposes an *immediate and permanent loss of income* on many retirees and other plan participants. The permanent loss of vested but *non-guaranteed* benefits, due to various PBGC limitations, can be devastating to the individuals affected. Although the agency has stopped disclosing these losses, PBGC's most recent report disclosed that the share of vested benefits permanently lost has risen substantially to 28% on average per participant among the one in seven retirees and participants that lose earned benefits when the agency takes over their plan.

As globalization and the acquisition of American companies by foreign firms and investors becomes increasingly common, there is a particular concern about the PBGC's ability to deter plan terminations by, or recover assets from, foreign-owned or foreign-based plan sponsors and named fiduciaries. The PBGC has had great difficulty persuading either U.S. or foreign courts to attach or enforce a lien against the assets of a plan sponsor outside the territorial jurisdiction of the U.S. Actually, collecting on a liability in practice requires that the foreign entities have sufficient assets within the jurisdiction of U.S. courts.

Unfortunately, the PBGC and other federal regulators lack the tools to protect retirees from unnecessary – and unnecessarily severe – terminations. ERISA's outdated and narrow protections create gaps that harm retirees and worsen the PBGC's long-term financial condition. To its credit, in many cases PBGC has been aggressive in using its limited statutory authority to negotiate additional contributions that at least delay or mitigate the negative impacts of a distress termination. However, these tools are neither broad enough in scope nor flexible enough with respect to the remedies available when dealing with an under-funded plan. There are major gaps in the law that undermine efforts to prevent a spin-off, acquisition by a foreign-owned entity, an intra-firm plan merger, or other transactions from making a pension plan more likely to default on its pension promises:

First, the PBGC's authority to seek increased funding for a plan or other remedies under ERISA §4042(a) is too limited, since in practice it is restricted to seeking the "nuclear option" of involuntary plan termination, which is itself a worst-case scenario for retirees. Regulators need the ability to temporarily enjoin a plan spin-off or merger and convince a court that a more tailored remedy – such as bonds backed by tangible assets or amortizing the under-funded liability—is appropriate and practical.

Second, a plan sponsor's immediate liability to fund vested benefits is triggered under ERISA §4062(e) *only if* more than 15% of the *active* participants are separated from the plan, typically due to a plant closing or mass layoff. However, the PBGC has no clear authority to go to court to demand additional funding, to impose liens or to initiate a termination proceeding, if necessary, when a spin-off or other transaction results in the transfer of unfunded benefit liabilities equal to 15% or more of total liabilities.

Third, the PBGC and Department of Labor (DOL) have a very limited ability to either attach or enforce a lien against the tangible assets of a contributing sponsor or other named fiduciary located outside the jurisdiction of the U.S. federal courts. It is not even clear the PBGC can perfect a lien against other U.S.-based assets or subsidiaries of a foreign company that are not part of the plan's controlled group.

Fourth, the PBGC needs to expand the transactions it scrutinizes under its Early Warning Program. The PBGC does not routinely monitor and review two types of transactions that expose the agency and retirees to potentially greater risk of loss: spin-offs (whether or not pension liabilities are transferred) and acquisitions of plan sponsors by non-U.S. firms (whether in whole or in substantial part).

Fifth, intra-firm plan mergers – which often follow M&A activity – should likewise be reportable events, as originally provided under ERISA, and subject to review and pre-approval by PBGC when any of the plans is at-risk (below 80% funded).

Finally, ERISA's definition of who is liable as a plan "fiduciary" will prove meaningless in a growing number of situations where the DOL and PBGC will be unable to hold certain non-U.S. fiduciaries accountable even for knowing and willful breaches of fiduciary duty that deplete plan assets.
The NRLN recommends six changes for legislation, regulatory reform and stepped-up enforcement:

1. **Congress should <u>give regulators broader and more flexible authority under Section 4042(a) to negotiate or seek court approval for a more tailored remedy, short of plan termination</u>**, to address spin-offs or other transactions that greatly increase the risk of future loss to the PBGC and participants.

2. Congress should further <u>amend Section 4042(a) to authorize the PBGC to initiate proceedings to terminate a plan</u>, or seek an alternative remedy short of plan termination, if a spin-off, controlled group break-up, takeover by a foreign entity or other <u>corporate transaction transfers 15% or more of the plan's benefit liabilities</u> without a commensurate and sufficient transfer of assets.

3. Congress should **<u>add the proposed transfer or spin-off of pension assets or liabilities to a foreign controlled group or entity to the list of transactions requiring an Advance Notice of Reportable Events</u>,** triggering special scrutiny under the PBGC's Early Warning Program.

4. Congress should **<u>require that intra-firm plan mergers are reportable events</u>, as ERISA originally required, <u>that require advance notice and review by PBGC</u>,** particularly if any of the plans are in at-risk status, as NRLN proposes in a separate white paper on *Defined Benefit Pension Plan Mergers*.

5. Congress needs to **<u>clarify that the PBGC has the authority to enforce a lien against all U.S.-based assets of the parent company of a foreign-owned plan sponsor</u>** even if those other assets or subsidiaries are not considered part of the controlled group sponsoring the plan.

6. The Department of Labor should revise its regulations to **<u>clarify that fiduciaries under ERISA – especially contributing sponsors and "named fiduciaries" – must be subject to the jurisdiction of federal district courts for the enforcement of judgments for potential breaches of fiduciary duty</u>**.

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I. Introduction and Background

For workers and retirees alike, the stakes are high when an under-funded pension plan is terminated or abandoned. Despite the benefit guarantees provided by the PBGC's insurance program, when an under-funded pension plan terminates it imposes an *immediate and permanent loss of income* on many retirees and other plan participants. The permanent loss of vested but *non-guaranteed* benefits, due to various PBGC limitations, can be devastating to the individuals affected.[1]

The gaps in PBGC's benefit guarantees are substantial and impact a substantial share of terminated plan participants each year. The PBGC itself reported in 2008 (the last year it made this data public) that on average 16% of participants lose non-guaranteed benefits in plans taken over by the agency, a share that tripled over the preceding ten years**.** The share of vested benefits permanently lost rose substantially to 28% on average per participant.[2]

For example, a study by the Government Accountability Office (GAO) identified five plan terminations that *each* resulted in more than $500 million in permanently lost benefits due to PBGC coverage limitations.[3] The largest losses occurred among the pilots and certain other airline employees at United, Delta Air Lines and U.S. Airways. At Delta, plan participants lost just under $3 billion in unfunded benefits (34.7% of their total vested but non-guaranteed benefits). At U.S. Airways, plan participants lost $9 billion of their vested but non-guaranteed benefits (20% of their total non-guaranteed benefits).

Preventing severe under-funding of plans – and taking action to avoid distress terminations that trigger these losses – needs to be a higher policy priority. Unfortunately, the PBGC and other federal regulators lack the tools to protect retirees from unnecessary – and unnecessarily severe – terminations.

As section II of this paper explains, the PBGC monitors a range of major corporate transactions and has in many cases aggressively leveraged the two statutory provisions that give it some ability to negotiate with firms to reduce under-funding and/or increase plan sponsor guarantees (such as bonds and liens on tangible assets). These negotiated agreements allow the PBGC to mitigate losses should the firm enter bankruptcy and terminate a substantially under-funded plan down the road. However, these tools are not nearly sufficient for the task. They are neither broad enough in scope nor flexible enough with respect to the remedies available to the agency when dealing with a severely under-funded plan.

ERISA was written in the context of a very different economy. In the 1970s, the share of workers and retirees participating in defined benefit pension plans was still expanding. Companies accumulating substantial pension liabilities were generally growing and healthy. There were few apparent incentives for companies to use financial engineering to shed legacy benefit costs. Indeed, the corporate form itself was more stable, with far fewer spin-offs and split-ups of the sort of firms that maintained traditional pension

[1] The four principal limitations on the Pension Benefit Guaranty Corp's protection of vested benefits are the maximum insurance guarantee (a maximum $6,030 per month at age 65 for 2021), the five-year phase-in of recent benefit increases, the "accrued at normal limitation" that discounts early retirement benefits, and the low payment priority given to any vested but non-guaranteed benefit by a participant retired (or eligible to retire) for less than three years prior to plan termination. *See* National Retirees Legislative Network, "Pension Guarantees that Work for Retirees: A Proposal for Commonsense PBGC Reforms," White Paper Series, *updated* January 2013, at pp. 6-7.

[2] Pension Benefit Guaranty Corporation, "PBGC's Guarantee Limits: An Update," September 2008, at p. 9, available at https://www.pbgc.gov/documents/guaranteelimits.pdf. PBGC has not disclosed updated data on lost benefits.

[3] General Accountability Office, "Pension Benefit Guaranty Corporation: More Strategic Approach Needed for Processing Complex Plans Prone to Delays and Overpayments," August 2009, Appendix VI, at p. 69.

plans that supported large numbers of retirees. Employers subject to ERISA were uniformly domestic, with few owned or controlled by foreign parents outside the jurisdiction of U.S. courts.

Of course, the economic landscape is very different today. And while it is important not to impede the greater productivity, profitability and efficiency that result from most corporate transactions and restructurings, it is equally important to update the rules of the road to ensure that plan sponsors and fiduciaries do not abuse gaps in the law – and its enforcement – that deny retirees and workers earned pension benefits, or that transfer a share of those losses onto taxpayers by abandoning an under-funded plan to the PBGC.

As section III of this paper explains, ERISA's outdated and narrow protections create a number of gaps that will do increasing harm both to retirees and to the PBGC's reported deficits unless Congress enacts at least a few modest changes. Five gaps in protections for retirees in the context of corporate mergers, acquisitions, spin-offs and foreign ownership are described in section III below. Each of these gaps will grow wider as both globalization and corporate financial engineering continues apace. These risks fall into two general categories:

First, there is an increasing trend toward corporate restructuring and other financial engineering that has the effect, whether intentional or not, of exposing legacy pension plans to a substantially greater chance of under-funding and an eventual distress termination. Certain corporate spin-offs, split-ups, mergers, acquisitions and takeovers have the effect of undermining the ability of the plan sponsor to support the make good on the plan's long-term obligations.

Second, there is the increasing prevalence of foreign ownership of U.S. firms with legacy pension liabilities, which itself is often results from a corporate spin-off, acquisition or restructuring. As explained below, while non-U.S.-based companies often improve the financial health of U.S. firms they acquire, the potential obstacles to the PBGC recovering financial losses due to an abandoned U.S. pension plan, or a breach of fiduciary duty, means that at a minimum the agency should always review acquisitions and pension transfers by non-U.S. firms under its Early Warning Program – and with the enhanced remedies recommended in section IV below.

The Increased Pension Risk from Spin-Offs, Mergers & Acquisitions

Certain corporate transactions – particularly the spin-off of under-performing subsidiaries – are likely to increase the long-term risk of a distress termination and benefit losses for retirees transferred in the deal. The PBGC seeks to identify these transaction-related risks through its award-winning Risk Mitigation and Early Warning Program. The Program's monitoring efforts focus on plans with: (1) underfunding of $50 million or more; or (2) 5,000 or more participants, determined on an aggregate controlled group basis.[4]

Strategic spin-offs of under-performing divisions is a well-established type of financial engineering that holds even greater appeal to investors – and risk to plan participants and the PBGC – when legacy pension, health and welfare benefits can be taken off the books of the parent company. For example, Verizon has done this twice in recent years by spinning off its Yellow Pages and New England rural wireline units that were both declining (due to the Internet and wireless line substitutions) and dragging down the overall profit margins of a company increasingly oriented toward the fast-growing mobile broadband data business. Separated from the parent, both units plunged into bankruptcy within three years. Belo Corporation is another example, profiled below, where the spin-off of the Texas-based media

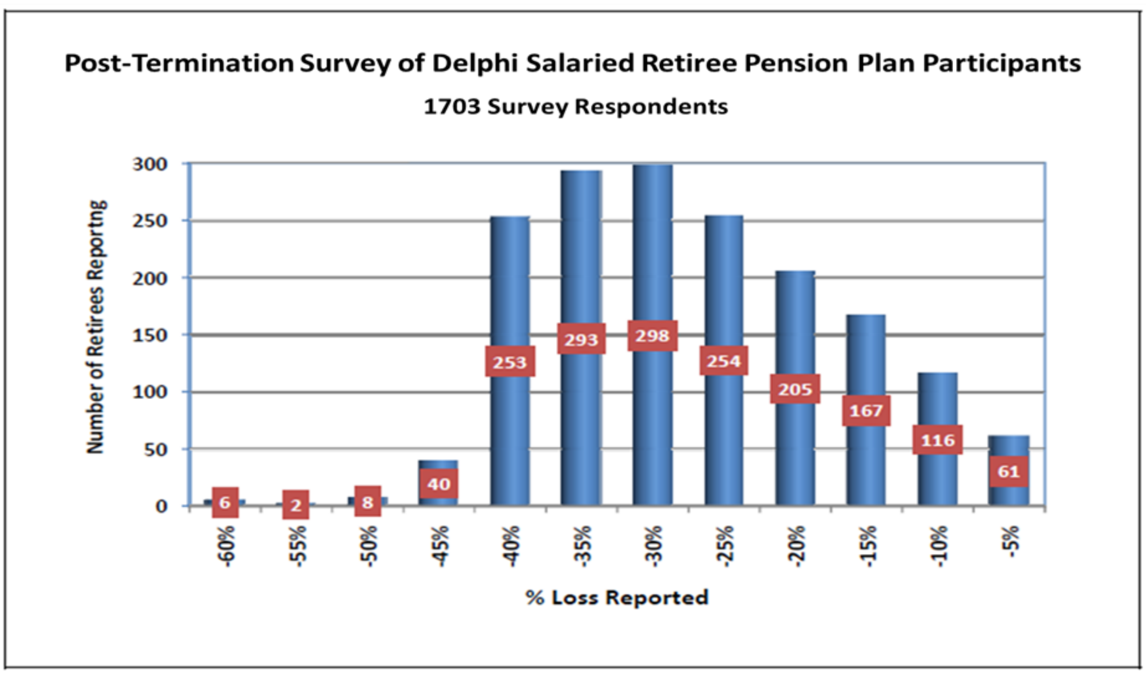
[4] For a list of the corporate transaction and event risks of particular concern to PBGC, see "Risk Mitigation and Early Warning Program," available at https://www.pbgc.gov/prac/risk-mitigation.

company's rapidly declining print newspaper unit (along with 60% of the company's overall pension liabilities) was a clear harbinger of a future distress termination.

The converse situation is the hollowing out of the parent company, where the pension liabilities are left behind as the more productive divisions of the original company are sold or spun off. A company can spin off its most productive and profitable division(s), leaving the legacy pension obligations (or a disproportionate share of them) behind in a likely-to-fail shell company.

The risks created by this second scenario was evident in the PBGC's intervention when Motorola announced in 2010 that it would spin off its consumer mobile handset business into a new company ("Motorola Mobility," acquired by Google), but leave all pension liabilities with the original company ("Motorola Solutions"). Without its mobility unit, Motorola Solutions would have less revenue to support contributions to the already-under-funded plan. In that case the PBGC was able to leverage its "nuclear option" to threaten court approval to terminate the plan under ERISA Section 4042(a) – which would impose immediate liability for under-funding – in order to obtain Motorola's agreement to contribute an additional $100 million to the plan. A more recent example is PBGC's negotiated agreements with Sears as it spun off valuable real estate and other assets prior to bankruptcy, which is described further below. However, the agency would be far better able to tailor remedies to protect retirees in a wider range of such transactions if Congress amends Section 4042(a), as recommended in section IV below.

Indeed, almost any announced spin-off, split-up or sale of a division by a U.S. company with legacy defined-benefit liabilities should send up a bright red warning flare that the retirees (and quite possibly the American taxpayer) will end up subsidizing the transaction if the now stand-alone unit deteriorates into bankruptcy. At Delphi Corporation, a now-bankrupt auto parts supplier spun-off by General Motors, the PBGC's controversial decision to terminate the pension plan for the company's salaried workers left a large portion of the participants with a permanent loss of between 20% and 40% of their vested benefits



(with some losing more than 40%).[5] Delphi evolved as part of GM until it was spun off as a separate entity in 1999. By 2005, the company employed more than 185,000 workers in 38 countries, making it one of the largest suppliers in the world. However, on October 8, 2005, Delphi Corporation and its U.S. subsidiaries filed for Chapter 11 bankruptcy protection. Four years later, the PBGC terminated all six of Delphi's U.S. defined-benefit plans and most of Delphi's U.S. and foreign operations were sold to a new entity, known as "New Delphi," in October 2009.[6]

In 2012, the GAO reported to Congress that Delphi's pension plans were underfunded by a combined $7.2 billion at termination and "many Delphi employees will receive a reduced pension benefit from PBGC compared with the benefits promised by their defined benefit plans."[7] A survey of Delphi plan participants with 1,700 respondents reported the following reductions in vested benefits paid by the PBGC:[8]

Those who lost	0 - 15%	=	344	=	20%	of 1,703 respondents
Those who lost	20 - 40%	=	1293	=	77 %	" " "
Those who lost	40% or more	=	56	=	3%	" " "

The Increased Risk from Foreign Control of U.S.-Based Pensions

As globalization and the acquisition of American companies by foreign firms and investors becomes increasingly common, there is a particular concern about the PBGC's ability to deter plan terminations by, or recover assets from, foreign-owned or foreign-based plan sponsors. As a legal matter, ERISA makes no distinction between U.S. and foreign-owned companies with respect to a plan sponsor's funding obligations, fiduciary duty and potential liability for vested benefits. Every member of an employer's "controlled group" is jointly and severally liable for pension underfunding in the case of a distress termination.

Despite their equal obligations under the law, as a practical matter the PBGC has had great difficulty persuading either U.S. or foreign courts to attach or to enforce a lien against the assets of a plan sponsor outside the territorial jurisdiction of the U.S. Collecting on a liability in practice requires that the foreign entities have sufficient assets within the jurisdiction of U.S. courts. As a result, the steadily increasing number of pension plans acquired by non-U.S. firms not subject to the jurisdiction of U.S. courts – and the growing number of foreign fiduciaries – requires new tools for regulators since it widens the gap in protections for retirees and other plan participants even further.

An increased volume of acquisitions and takeovers of U.S. firms and spin-offs by foreign buyers is both a two-decade trend and inevitable in a global economy where capital flows more freely and geographic borders matter less than the strengths and weaknesses of increasingly multinational companies. There is little question that the share of foreign-based multinationals and investors, including foreign governments,

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[5] The PBGC left the hourly workers' plan intact after Delphi's former parent, General Motors, then under the control of its majority owner, the U.S. Department of the Treasury, decided to make good on an agreement to contribute to the solvency of the plan.

[6] GAO, "Troubled Asset Relief Program: Automaker Pension Funding and Multiple Federal Roles Pose Challenges for the Future," April 2010, Appendix 1, available at http://www.gao.gov/new.items/d10492.pdf. *See also* http://www2.americanbar.org/calendar/ll0216-2011-midwinter-meeting/Documents/chapter_09_01.pdf

[7] GAO, Testimony of A. Nicole Clowers before the Subcommittee on TARP, Financial Services and Bailouts, Committee on Oversight and Government Reform, U.S. House of Representatives (July 10, 2012).

[8] Delphi Salaried Retirees' Association, 2010 Survey of 6,700 participants in the Delphi Retirement Program for Salaried Employees. Significantly, 73% of the 1,703 respondents were under the age of 65 at the time of plan termination, with 44% between age 60 and 64. The PBGC's maximum benefit guarantee for 2021 – $72,000 for a retiree who is age 65 at plan termination – is reduced substantially for each year under age 65.

acquiring U.S. companies with substantial pension liabilities is steadily rising. U.S. Commerce Department data shows that in 2015 foreign firms spent $408 billion to acquire 791 existing U.S. firms, nearly doubling the $236 billion spent to acquire U.S. firms in 2014.[9] Cumulative foreign direct investment rose to $7.4 trillion at market value by year-end 2016 – more than doubling after 2008 – and is no doubt considerably higher today.[10]

Affiliates of foreign firms operating in the U.S. employed more than 6.6 million Americans in 2016.[11] While foreign investment can benefit the U.S. economy when it creates new production, the Congressional Research Service found that by value, "acquisitions of existing U.S. firms accounted for more than 96% of new foreign investments in 2015" and that "acquisitions of existing U.S. firms accounted for 99% of employment associated with foreign investment in 2015."[12] More than one-third of the workers employed by foreign-owned firms are in the manufacturing sector, where firms pay higher wages and are far more likely to maintain legacy pension, health and welfare benefit plans. And according to the Congressional Research Service, "[t]he average plant size for foreign-owned firms is much larger – five times larger – than for U.S. firms, on average, in similar industries."[13]

While many foreign buyers increase investment in their U.S. subsidiaries, others take over U.S. firms to gain access to U.S. markets, or to U.S. technology, and reduce domestic employment and retirement security overall. One of the largest cross-border pension plan transfers in history was the 2006 acquisition of Lucent Technologies by French telecom equipment maker Alcatel. The merged Alcatel-Lucent, based in Paris, immediately cut thousands of U.S. jobs. Since retirees represented the overwhelming majority of the participants in pension plans of the struggling Alcatel-Lucent USA subsidiary, they were legitimately concerned about whether the Paris-based firm would honor the company's pension promises – and, if not, whether U.S. regulators have the tools and authority to keep retirees whole. Heightening those concerns, in January 2016 another foreign firm – Nokia – acquired Alcatel. Most recently, in 2020, Nokia itself is rumored to be a takeover target.[14]

II. THE PBGC'S EXISTING TOOLS ARE TOO LIMITED TO PROTECT RETIREES

To its credit the PBGC has at times been aggressive in using the very limited statutory levers outlined just below to negotiate additional contributions that at least delay or mitigate the negative impacts of a distress termination. However, these tools are neither broad enough in scope nor flexible enough with respect to the remedies available to the agency when dealing with an under-funded plan.

A. The 'Nuclear Option': Involuntary Termination Under ERISA § 4042(a)(4)

At present, the government's primary authority to protect retirees and other plan participants in the aftermath of a corporate spin-off or other M&A transaction is the PBGC's ability to initiate an

[9] James K. Jackson, "Foreign Direct Investment in the United States: An Economic Analysis," Congressional Research Service (June 29, 2017), at p. 12. *Compare* James K. Jackson, "Foreign Direct Investment in the United States: An Economic Analysis," Congressional Research Service (October 26, 2012), at p. 6.
[10] James K. Jackson, "Foreign Direct Investment in the United States: An Economic Analysis," Congressional Research Service (June 29, 2017), at p. 2.
[11] *Id*. at p. 10.
[12] *Id*. at p. 11.
[13] James K. Jackson, "Foreign Direct Investment in the United States: An Economic Analysis," Congressional Research Service (July 28, 2010), at p. 5.
[14] Reuters, "Nokia Shares Surge on Report of Takeover Bid" (April 16, 2020).

involuntary plan termination. Under ERISA § 4042(a)(4), the PBGC "may institute proceedings . . . to terminate a plan whenever it determines that the possible long-run loss of the corporation with respect to the plan may reasonably be expected to increase unreasonably if the plan is not terminated."

Although the PBGC has no authority to block a spin-off or other transaction, the agency can threaten to seek the permission of a U.S. District Court to institute an involuntary termination under section 4042(a). Because the company would be immediately liable for the present value of all vested benefits calculated using the very low discount rate that the PBGC uses to calculate termination liability, a credible threat from the PBGC could scuttle the transaction.[15] Even if the PBGC is not likely to prevail in court, its review and public statements questioning the pension impact of the transaction – and raising the possibility of termination liability – can become an obstacle to timely completion of the transaction. As a result, in a number of cases the agency has been able to extract concessions that seek to shore up underfunding or otherwise protect the PBGC from larger losses if the plan terminates at a later date.

During fiscal year 2016, under its Early Warning Program the PBGC "negotiated almost $3 billion in financial assurance to protect more than 367,000 people in plans at risk from corporate events and transactions."[16] Testifying before the Senate, former PBGC Executive Director Josh Gotbaum highlighted the use of this authority (as well as Section 4062(e), noted just below) as a tool the agency was using more aggressively in an effort to avoid taking over the plans of troubled companies:

> Under the Early Warning Program, PBGC monitored more than 1,000 companies to identify transactions that could threaten a company's ability to pay pensions and negotiated protections for the plans. When major layoffs or plant closures threaten a plan's viability, PBGC can step in and negotiate protection for the pension plan, including a guarantee, posting of collateral or contributions to the plan. In this way, last year PBGC secured an additional $250 million for participants in 20 pension plans. When companies do enter bankruptcy, we encourage them to keep their plans intact.[17]

Although the PBGC does not frequently wield the threat of involuntary termination to extract funding concessions, the agency has leveraged this authority more often in recent years. The following examples illustrate the potential for negotiated agreements to mitigate the risk that can result from spin-offs and other corporate transactions involving firms with underfunded pension plans:

Sears Spin-Offs and Asset Sales: In 2016 the PBGC negotiated a "pension protection agreement" with Sears that required the rapidly declining company to grant "springing liens" on as much as $2.7 billion in

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[15] When an underfunded pension plan is terminated, the PBGC has a claim against the plan sponsor and each member of its controlled group equal to the entire amount of underfunded benefit liabilities. The PBGC chooses to estimate a plan sponsor's "termination liability" using a discount rate derived from the price that commercial insurance companies charge for fixed and deferred annuities. This discount rate has typically been substantially lower than the AA corporate bond yield curve that plan sponsors are required to use to estimate and report their liabilities and minimum funding requirements. Because the PBGC assumes a much lower discount rate on future benefit obligations, even a plan considered to be fully funded on an ongoing basis will be roughly 30% underfunded on a termination basis, which is potentially an enormous liability. *See* National Retirees Legislative Network, *Pension Guarantees that Work for Retirees: A Proposal for Commonsense PBGC Reforms*, White Paper Series, *updated* January 2013.

[16] Pension Benefit Guaranty Corporation, *2016 Annual Report* (Nov. 2016), at 2, available at http://www.pbgc.gov/Documents/2016-Annual-Report.pdf.

[17] Statement of Joshua Gotbaum, Director, Pension Benefit Guaranty Corporation before the Senate Committee on Health, Education, Labor & Pensions, Dec. 1, 2010, available at https://www.help.senate.gov/hearings/pbgc-is-stronger-management-and-oversight-neededd.

real estate and other valuable assets that Sears had placed in subsidiaries that could be spun-off free and clear of the retailer's pension obligations. The liens negotiated by PBGC would be triggered by Sears's "failure to make required contributions to the plan, by prohibited transfers of ownership interests in the subsidiaries, termination of the pension plan, or bankruptcy of the company or certain subsidiaries."[18] In 2017, in exchange for PBGC's consent to Sears' sale of its Craftsman brand to Stanley Black & Decker, the company's pension plans (which covered nearly 200,000 participants at the time) "received rights to a $250 million payment . . . and a 15-year income stream relating to future SBD sales of Craftsman products."[19] In total, the liens and payments negotiated by PBGC led to $1 billion in contributions to the Sears pension plan.[20] Sears declared bankruptcy in late 2018 and the PBGC took the plans over in 2019.

Alcoa, Inc. Split-Up: In October 2016 the PBGC announced that Alcoa would make cash contributions totaling $150 million over two years on top of its required pension contributions.[21] Alcoa had given notice that it intended to split the company into two separate firms: the legacy mining and commodities business, and a new one focused on value-added multi-material products and solutions. Since Alcoa's eight pension plans are underfunded, the agreement helps to protect more than 102,000 retirees and other participants.[22]

Motorola Spin-Off: In 2010 Motorola announced it would spin off Motorola Mobility, its division that primarily produced smartphones, to Google. The company's remaining business, renamed Motorola Solutions, retained all of the legacy pension plan liabilities. As a result, the future growth and revenue from the mobile phone portion of the business would no longer contribute to the pension plan, which had 87,000 participants, the majority of them retirees. On January 4, 2011 the PBGC announced that Motorola Solutions had agreed to contribute an additional $100 million to the Motorola Pension Plan over the next five years above and beyond legal requirements.[23]

***A.H. Belo Spin-Off*:** Belo Corp., a Dallas-based broadcasting company, spun off its declining newspaper business, creating A.H. Belo as a separate company (and a pure newspaper play). In 2010, the companies agreed to transfer roughly 60% of the assets and liabilities of the Belo pension plan to the financially weaker spin-off. The PBGC questioned the transaction, particularly with respect to the ongoing funding level of the new A.H. Belo plan, which would now be supported entirely by a declining newspaper business (and not by the more profitable chain of local television stations that remained with the parent). In March 2011 the two companies signed an agreement with the PBGC requiring an additional $30 million payment to the new A.H. Belo plan above and beyond contributions required by ERISA.[24] The PBGC also reserved its right to come back at the previous plan sponsor (the more profitable Belo) if A.H. Belo declares bankruptcy or otherwise defaults.[25]

Daimler Sale of Chrysler: One of the largest PBGC settlements involved the sale of a controlling interest in Chrysler by the German automaker Daimler to Cerberus, a U.S.-based hedge fund. In 2007 DaimlerChrysler agreed to a $1 billion termination guarantee negotiated by the PBGC. In August 2009, when Daimler sought to transfer its remaining 20% ownership stake, the PBGC negotiated additional cash

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[18] PBGC, *2016 Annual Report*, at p. 5.
[19] PBGC, *2017 Annual Report*, at p. 5.
[20] PBGC, *2018 Annual Report*, at p. 5.
[21] "PBGC and Alcoa Inc. Reach Agreement on $150 Million in Additional Pension Funding," PBGC News Release (Oct. 11, 2016), available at http://www.pbgc.gov/news/press/releases/pr16-15.html.
[22] *Id*. and PBGC, *2016 Annual Report*, at p. 5.
[23] *See* PBGC News Release, "PBGC, Motorola Agree on $100 Million in Pension Protection," Jan. 4, 2011.
[24] Timothy Inklebarger, "Belo DB Pension Plans Split," *Pensions & Investments*, Jan. 4, 2011, available at http://www.pionline.com/article/20110104/DAILYREG/110109981#ixzz1ORmP47Gw.
[25] Agreement between A.H. Belo, Belo Corp. and PBGC, Exhibit 10.3.6, A.H. Belo Annual Report on Form 10-K (March 11, 2011), available at http://investor.ahbelo.com/phoenix.zhtml?c=219524&p=irol-sec.

contributions by Daimler and an extension of the guarantee (in case Chrysler's plan terminated). E.F. Millard, then interim PBGC director, announced that the Chrysler "pension plans will receive an infusion of $200 million in extra contributions, and Daimler will provide a $1 billion guarantee for up to five years."[26] Ironically, it was another foreign automaker, Italy's Fiat, that stepped up to purchase the bulk of the assets of Chrysler LLC in 2009 through a new corporate entity whose equity is owned by a group that includes Fiat Corp., the United Auto Workers, and the U.S. and Canadian governments.[27] The bankruptcy, which proceeded with the recommendations of the Automotive Task Force, preserved the pension plans by transferring them to the new Chrysler. Fiat acquired a majority interest in June 2011.

Despite these successes, the PBGC itself considers its authority under Section 4042(a)(4) a "nuclear option" that is of limited utility for preventing a spin-off or other material transaction from undermining the long-term solvency of a pension plan. This is true for a number of reasons that are described in the next section. Foremost among them is that the PBGC's only available remedy is to kill the patient. The agency's threat is premised on acquiring a federal district judge's approval to allow, over the company's objections, an involuntary termination that imposes permanent losses on many younger retirees and older workers, as well as adding to the PBGC's projected deficit (which, although exaggerated by the agency's use of an ultra-low insurance industry discount rate, is nonetheless substantial).[28]

The NRLN believes ERISA should give regulators a greater ability to temporarily enjoin a spin-off or other M&A activity and convince a court that a more tailored remedy, short of plan termination, is appropriate and practical.

B. Major Layoffs: Negotiating Contributions Under ERISA § 4062(e)

The other principal statutory provision that can be leveraged to reduce pension underfunding and protect at least some plan participants in the context of a corporate restructuring is ERISA Section 4062(e), which is triggered by a "permanent cessation of operations." If an employer closes a facility and this results in a workforce reduction "equivalent to more than 15 percent" of the number of employees eligible to participate in any employee pension plan (including a 401(k) plan), the employer becomes immediately liable for that same percentage of the plan's total unfunded liability calculated on a termination basis.[29] The PBGC typically seeks financial assurance, such as additional contributions or a form of guarantee that the laid-off workers' vested benefits will be funded. As noted above, since PBGC's calculation of termination liability is greatly inflated compared to the funding levels that ongoing pension plans report to

[26] Statement of PBGC Interim Director Charles E.F. Millard on Protection Secured for Chrysler Pensions, August 3, 2007. *See also* Statement of PBGC Interim Director Charles E.F. Millard on Protection Secured for Chrysler Pensions, August 3, 2007.

[27] PBGC, "Chrysler Pension Plans Continue Under New Company Sponsorship," PBGC New Release No. 09-35, June 10, 2009.

[28] *See* National Retirees Legislative Network, "Pension Guarantees that Work for Retirees: A Proposal for Commonsense PBGC Reforms," White Paper Series, *updated* September 2017.

[29] ERISA § 4062(e), 29 U.S. Code § 1362(e), available at http://www.pbgc.gov/Documents/Bill-Text-113th-Congress-2013-2014-hr83enr-.pdf. Congress amended Section 4062(e) in 2014, creating exemptions for small plans (less than 100 employees) and for plans funded at 90% or better in the plan year before the facility closing (and calculated using the more market-oriented high-quality bond yield curves provided in the Pension Protection Act of 2006). If a plan is exempt, no reporting to PBGC is required. PBGC's summary is available at: http://www.pbgc.gov/about/faq/pg/important-changes-to-erisa-section-4062(e).html.

participants under ERISA's rules, immediate liability for even 25% or more of the total termination liability is a burden companies are often motivated to negotiate and resolve.[30]

A decade ago the PBGC demonstrated it could use this provision to negotiate greater protections for plan participants. Between 2007 and 2012 the PBGC used the section 4062(e) cessation of operations provision to obtain more than $1 billion in additional contributions or guarantees for pension plans covering more than 200,000 workers and retirees.[31]

Of course, if a company is declaring bankruptcy and eligible for a distress termination, this provision is largely moot. However, where the firm weathers the downsizing and continues on, the PBGC has been able to negotiate significant additional contributions, including from foreign-controlled companies that otherwise might not be subject to court-imposed liens against their remaining U.S. assets.[32] Where plan sponsors credibly demonstrate that immediate cash payment of the liability is impractical or could disrupt the company, the PBGC has negotiated agreements to amortize payments and/or accept a mechanism (such as an escrow account or collateralized bond) to guarantee payment. Some notable examples include:

Bendix Commercial Vehicle Systems: The PBGC sued Bendix in federal District Court after the firm declined to guarantee $16.6 million in benefits for 63 workers displaced by the company's plant closure in Lexington, Kentucky"[33] The company settled in 2012, agreeing to contribute an additional $8.2 million and to provide a contingent letter of credit for the remaining $8.4 million if its financial condition worsened any further.[34]

Borg Warner: After Borg Warner shuttered its Muncie, Indiana auto transmission parts plant in 2009, laying off more than 3,000 active plan participants, the PBGC negotiated $111 million in additional contributions over a four-year period.[35]

Visteon: After Ford Motor Company spun off Visteon, its auto parts subsidiary, the firm began downsizing through plant closings. A mass layoff of 5,300 workers at two Indiana plants triggered the company's liability under section 4062(e). Prior to Visteon's 2009 bankruptcy filing, PBGC negotiated with Visteon and Ford to contribute an additional $55 million.[36] Once in bankruptcy, Visteon sought to terminate three of its four plans, a "move that would have caused $100 million in benefit reductions for

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[30] The plan sponsor can satisfy this liability either by increasing the plan's funding level by that same amount, or by putting the unfunded liability in escrow, or posting a bond backed by collateral. In the latter case, if the plan terminates within five years, the escrowed funds or bond is added to plan assets.

[31] During FY 2012, PBGC reached settlements with 27 companies for $471 million to protect almost 50,000 participants. PBGC, *2012 Annual Report*, at p. 7, available at http://www.pbgc.gov/res/reports/ar2012.html. According to the PBGC's *2010 Annual Report*, "[d]uring FY 2010, PBGC opened 129 new 4062(e) cases, as compared with 105 in 2009 and 40 in 2008, and reached settlements with 20 companies for approximately $250 million." PBGC, *2010 Annual Report*, at p. 9, available at http://www.pbgc.gov/docs/2010_annual_report.pdf.

[32] Under ERISA § 4067, the PBGC believes it has broad discretionary authority to settle any liability under § 4062, "including arrangements for deferred payment of amounts of liability to the corporation accruing as of the termination date on such terms and for such periods as the corporation deems equitable and appropriate."

[33] PBGC News Release, "PBGC Sues Bendix for Pension Debt," October 28, 2011, available at http://www.pbgc.gov/news/press/releases/pr12-03.html.

[34] PBGC News Release, "PBGC, Bendix Reach Settlement, End Litigation, May 2, 2012, available at http://www.pbgc.gov/news/press/releases/pr12-21.html.

[35] "PBGC Negotiates $111 Million of Additional Pension Protection for Indiana Workers at BorgWarner," PBGC News Release No. 10-26, March 24, 2010, available at http://www.pbgc.gov/news/press/releases/pr10-26.html.

[36] "PBGC Negotiates $55 Million in Pension Protection with Visteon Corp.," PBGC News Release No. 09-11, January 05, 2009.

the company's 22,000 workers and retirees."[37] The PBGC renegotiated an agreement to keep the plans operating, which also avoided $500 million in additional liabilities for PBGC.

Elkem: In July 2008 the PBGC announced an agreement with Norwegian-owned Elkem Metals Inc. that promised to boost funding for the pension plan of 1,600 workers and retirees by $17.3 million and to guarantee another $22 million if the PBGC later takes over the plan. Approximately 80% of Elkem's active participants were separated from the plan when the company sold plants in Oklahoma and West Virginia to buyers who would not agree to assume the liabilities of the company's retirement plan.[38]

Electrolux: After Swedish-owned Electrolux Home Products Inc. shut down its plant in Greenville, Michigan in 2006, the PBGC reached a $77.5 million agreement to shore up funding for the benefits of more than 2,350 former employees. The 2007 settlement aimed to bring the company's under-funded plans up to full funding over a five-year period.[39]

Congress amended Section 4062(e) in 2014, narrowing its reach by creating exemptions for small plans (less than 100 employees) and for plans funded at 90% or better. Firms in these categories are exempt from reporting. The PBGC subsequently lifted its moratorium on enforcement, but the agency also appears to have limited its focus to plan sponsors at severe risk of bankruptcy or distress termination: "PBGC will generally take no action to enforce section 4062(e) liability against creditworthy companies or small plans and target its 4062(e) enforcement efforts to companies where the risk remains substantial."[40]

The partial termination liability triggered by major plant closings or mass lay-offs under ERISA section 4062(e) allows the PBGC to shore up the funding of impacted plans to some degree. However, while useful, **the narrow 15% force reduction requirement fails to trigger liability for under-funding with respect to a range of other transactions that often pose even greater risk to *all* plan participants,** the vast majority of whom are often retirees and not active workers. These include not merely substantial downsizings, but also spin-offs, control group break-ups and takeovers by foreign-owned firms largely beyond the reach of the PBGC and ERISA fiduciary enforcement. This gap in Section 4062(e)'s ability to protect retirees is described further in the next section.

C. Lookback Liability: Transactions Intended to Evade Liability Under § 4069

Although rarely used, one additional statutory tool available to the PBGC is ERISA section 4069, which imposes termination liability retrospectively on a contributing plan sponsor if it can be shown that "a principal purpose" of "any transaction is to evade liability" and the transaction that results in a distress termination "becomes effective within five years before the termination date" of the plan.[41] Among the

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[37] "Statement of PBGC Director Joshua Gotbaum on Visteon Plan of Reorganization," PBGC News Release No. 10-49, August 31, 2010. *See also* Timothy Inklebarger, "Visteon Plans Underfunded by $893 Million," *Pensions & Investments*, May 28, 2009, available at http://www.pionline.com/article/20090528/DAILYREG/905289980.

[38] "PBGC Negotiates Deal to Strengthen Pension Funding at Elkem Metals Inc.," PBGC News Release No. 8-40, July 24, 2008.

[39] "PBGC Negotiates Pension Protection with Electrolux Home Products," PBGC News Release No. 08-13, December 13, 2007, available at http://www.pbgc.gov/news/press/releases/pr08-13.html.

[40] *See* PBGC, "Important Changes to ERISA Section 4062(e)," https://www.pbgc.gov/about/faq/pg/important-changes-to-erisa-section-4062%28e%29; PBGC, "Frequently Asked Questions: Section 4062(e) Enforcement Pilot Program," http://www.pbgc.gov/about/faq/pg/frequently-asked-questions-4062.html.

[41] ERISA § 4069(a).

corporate transactions referenced in the statute are mergers, consolidations or spin-offs, as well as "liquidation into a parent corporation."[42]

A recent but rare example of the PBGC using this provision to protect workers and retirees resulted in a March 2016 settlement that restored the pension plans of approximately 1,350 retirees of RG Steel, a formerly wholly-owned subsidiary of the Rencro Group.[43] Renco had tried to escape liability for two steelworker pension plans it had previously acquired by spinning them off to a weaker entity that later declared bankruptcy and terminated the plans, which were $70 million underfunded. PBGC brought an action under ERISA Section 4069, which led to the settlement, restoring the plans and paying $35 million in shutdown benefits covered by the plans, but not guaranteed by PBGC.[44] The PBGC prevailed largely because it used the controlled group joint and several liability provisions of ERISA to assert claims against entities that are not involved in the steel business, but that were controlled by Renco and its controlling shareholder Ira Rennert.

Renco also highlights another limitation, which is that section 4069 can be invoked only *after* a distress termination. This is an unfortunate gap, since a strategic spin-off that either transfers or retains the under-funded legacy obligations for retiree benefits in a hollowed-out shell, is a maneuver the PBGC's Early Warning System is intended to flag. For example, Motorola's division into two independent firms at the end of 2010 could arguably have triggered this provision if the legacy half of the company declared bankruptcy and defaulted on its pension obligations (which are overwhelmingly to retirees, not actives) within five years. However, even when section 4069 is applicable, there are so many other business reasons for such a transaction that it can be extremely difficult to convince a court that "a principal purpose" of the spin-off (rather than a mere inadvertent outcome) was to evade pension liability by making it more likely they would be assumed by the PBGC when the crippled parent finally failed.

D. Risk Mitigation: Early Warning Program and Reportable Events Under § 4043

The PBGC's Early Warning Program (EWP) monitors financially weak companies and corporate transactions that appear to pose a risk of long-run loss to the pension insurance program.[45] The EWP generally receives high marks for monitoring companies with significant underfunding. It currently monitors 1,100 companies with more than $50 million in underfunding. It also screens for and monitors companies with below-investment-grade bond ratings and underfunding in excess of $5 million. In addition, the PBGC monitors notifications of a wide range of "reportable events," the most potentially significant of which (e.g., pension liability transfers, liquidations, bankruptcy, loan defaults, or change in contributing plan sponsor) require non-public companies to file notification of the transaction with the PBGC at least 30 days in advance of the closing date.

The PBGC articulated the purpose of its monitoring efforts in a November 2009 notice of rule making that proposed the addition of two additional reportable events as well as ending most automatic waivers of company reporting obligations:

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[42] ERISA § 4069(b).

[43] *See* PBGC, *2016 Annual Report*, at p. 6, available at http://www.pbgc.gov/Documents/2016-Annual-Report.pdf.

[44] *See* Hazel Bradford, "Renco Group to take back 2 plans from PBGC; marks second time in agency history," *Pensions & Investments* (March 4, 2016), available at http://www.pionline.com/article/20160304/ONLINE/160309929/renco-group-to-take-back-2-plans-from-pbgc-marks-second-time-in-agency-history.

[45] *See* PBGC, "Risk Mitigation and Early Warning Program," Overview, available at https://www.pbgc.gov/prac/risk-mitigation.

> Reportable events often signal financial distress and possible plan termination. When PBGC has timely information about a reportable event, it can take steps to encourage plan continuation—for example, by exploring alternative funding options with the plan sponsor—or, if plan termination is called for, to minimize the plan's potential funding shortfall . . . . Without such timely information, PBGC typically learns that a plan is in danger only when most opportunities for protecting participants and the pension insurance system may have been lost.[46]

The EWP is not mandated by ERISA, but created and expanded by the PBGC under its authority to initiate a preemptive plan termination under Section 4042.[47] Although the PBGC has no authority to veto a transaction, it can and has extracted concessions that seek to shore up underfunding or to protect the PBGC's position as part of the transaction. Under this authority, the PBGC has leverage because it can threaten a company with involuntary termination, as described above. It can also make public statements that result in negative media coverage and potentially weaken the company's position.

According to PBGC staff managing the EWP, the agency is particularly on the lookout for material transactions (including spin-offs, LBOs, extraordinary dividends, asset divestitures) that could down the road make an already-underfunded plan much more vulnerable to a distress termination. The staff emphasizes that by using two different screens (one based on reportable transactions, irrespective of underfunding; the other based on underfunding and deterioration of credit agency bond ratings) they believe that they are monitoring most companies with a heightened risk of termination. The complete list of Advance and Post-Event reportable transactions are detailed in Part 4043 of the PBGC's regulations.[48]

The following are examples of events that plan sponsors must report to the PBGC, although there are complex waivers that create exemptions in many cases:[49]

• **Change in Controlled Group**: Change in the plan's sponsor or a discontinuance of members in a controlled group. Notice is waived if the sponsor is a public company and the plan's funded vested benefit percentage is 80% or more, or the change represents a *de minimis* 10% segment of the controlled group.

• **Extraordinary Dividends and Stock Redemptions**: The sponsor or a controlled group member declares a dividend or distribution which exceeds certain limits, or redeems stock. Notice is waived if the distribution is made by a foreign entity, other than a foreign parent, unless the foreign parent is making the distribution solely to other controlled group members.

• **Transfer of Plan Liabilities**. The plan transfers 3% or more of its liabilities to a plan or plans maintained outside of the controlled group. Notice is waived if (i) there is a transfer of all of the plan's

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[46] PBGC, "Proposed Rule: Reportable Events and Certain Other Notification Requirements," 74 Federal Register 61,248 (Nov. 23, 2009), available at http://www.setonresourcecenter.com/register/2009/nov/23/E9-28056.pdf. "PBGC believes that many of the automatic waivers and extensions in the existing reportable events regulation are depriving it of early warnings that would enable it to mitigate distress situations. For example, of the 88 small plans terminated in 2007, 21 involved situations where, but for an automatic waiver, an active participant reduction reportable event notice would have been required an average of three years before termination." *Ibid*, at p. 61251.

[47] Under ERISA section 4042(a)(4), the PBGC "may institute proceedings . . . to terminate a plan whenever it determines that the possible long-run loss of the corporation with respect to the plan may reasonably be expected to increase unreasonably if the plan is not terminated."

[48] 29 CFR Part 4043. Section 4043 of ERISA requires that PBGC be notified of the occurrence of certain "reportable events" that may signal financial issues with the plan or a contributing employer. The statute provides for both post-event and advance reporting.

[49] "PBGC Reportable Event Notices and Facility Shutdown Liability," Latham & Watkins Tax Department, *Client Alert*, June 25, 2009.

assets and liabilities, (ii) the transfer complies with Internal Revenue Code Section 414(l), using PBGC actuarial assumptions, or (iii) both plans are fully funded after the transfer, using PBGC assumptions.

• **Distribution to Substantial Owner**: The plan distributes more than a certain amount to a substantial owner of the sponsor and after such distribution the plan has unfunded vested benefits. Notice is waived if the distribution is upon death and the plan meets certain funding requirements.

Generally notice must be given to the PBGC within 30 days after the reportable event occurs. However, certain companies with substantially underfunded plans (more than $50 million in unfunded vested benefits and less than 90% funded overall) are required to report certain events 30 days in advance.

E. Transfers of Pension Liability Must be Funded Under IRC § 414(l)

As noted above, the PBGC has the authority under ERISA section 4042(a) to review a spin-off to determine whether the transaction "unreasonably" increases the risk of long-run loss to the pension insurance system. In addition, Section 414(l) of the Internal Revenue Code provides, in part, that each plan participant must be eligible to receive a benefit immediately after any pension plan merger or spin-off that is equal to or greater than the benefit he would have been entitled to receive immediately before the transaction. Section 414(l) is intended to prevent a plan sponsor from using a spin-off or transfer to either cut vested benefits for a group of participants or to reduce the proportion of assets available to pay for them.

In practice, however, this provision is narrow in scope and protects retirees only in a small subset of corporate transactions. Section 414(l) exempts "spin-offs" that involve the transfer of the entire plan to a new controlled group.[50] It also exempts situations where the acquiring firm terminates the pension plan as part of the transaction.[51] If some portion of a qualified plan's liabilities is transferred in a corporate spin-off or other sale, it must be funded by a proportional allocation of plan assets.[52] If the transferred liabilities are not fully funded using the PBGC assumptions for calculating termination liability, a reportable event filing must be made to the PBGC including an explanation of the assumptions used.[53]

III. GAPS IN PROTECTIONS FOR RETIREES IN CORPORATE MERGERS & ACQUISITIONS

As the section above explains, ERISA provides a weak patchwork of protections against spin-offs, mergers, foreign acquisition, plant shutdown or other financial engineering that threaten the likelihood that a pension plan will meet its benefit obligations – and not default to the PBGC. Although traditional pension benefits are insured by PBGC, an insolvent or abandoned pension plan inevitably means that many retirees and older workers lose a substantial portion of their promised retirement income. Recall

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[50] I.R.C. § 414(l)(2)(D)(ii) provides that the general protection described in § 414(l) does not apply "if, after such spin-off, such plan is maintained by an employer who is not a member of the same controlled group as the employer maintaining the original plan."
[51] I.R.C. § 414(l)(2)(D)(iv).
[52] Internal Revenue Code § 414(l). In this context, the term "spinoff" means the splitting of a single plan into two or more plans. Treas. Reg. 1.414(l)-1(b)(4). IRC § 6058(b) requires plan administrators to file a report with the IRS not less than 30 days before a merger, consolidation or transfer of assets or liabilities from one plan to another. Internal Revenue Code Section 414(l)'s provisions regarding the allocation of assets in a plan spin-off are enforced by the IRS and are not reviewed by PBGC.
[53] *See* 29 Code of Federal Regulations § 4043.32. Although PBGC's methodology for estimating termination liability is a safe harbor, often the actuary for the transferring plan certifies that the assumptions used are reasonable.

that even among retirees and older workers who have earned a monthly pension benefit below the maximum amount insured by PBGC, the permanent loss of vested but non-guaranteed benefits can be substantial. While the majority of retirees are not impacted by the PBGC's guarantee limits, the most recent data disclosed by the PBGC reported that on average 16 percent of participants lose non-guaranteed benefits when plans are taken over by the agency and, due to a variety of PBGC practices, the share of vested benefits *permanently lost* has risen substantially to 28% on average per participant.[54]

The single largest legal gap in the protections for retiree benefits is the status of pension liabilities in bankruptcy proceedings. While this paper focuses on corporate M&A activity that does *not* involve bankruptcy (although recognizing that these transactions often presage bankruptcy and a pension default years later), the NRLN describes the problem of bankruptcy in a separate white paper.[55] Despite the fact that Congress legislated special procedural and substantive protections for retiree benefits in bankruptcy, particularly through the retiree committee provided for under section 1114 of the Bankruptcy Code, recent high-profile corporate bankruptcy cases have highlighted (and in some cases created) the loopholes that result in pension liabilities receiving a low priority for payment.

Since the termination of a substantially under-funded plan is the worst outcome for retirees, employees and the PBGC, the agency for a number of years became more aggressive in using the very limited statutory levers outlined in the section above to negotiate additional contributions that at least delay or mitigate the negative impacts of a distress termination. However, as described in the remainder of this section, **there are five major gaps in the agency's ability to prevent a spin-off, split-up, merger, increase in foreign ownership, or other material transactions from making a pension plan more likely to default** on its pension promises:

First, the PBGC's authority to seek increased funding or other remedies under ERISA section 4042(a) is too limited, since in practice it is restricted to the "nuclear option" of seeking involuntary plan termination, which is itself a worst-case scenario for retirees. Regulators need the ability to temporarily enjoin a spin-off or other M&A activity and convince a court that a more tailored remedy, short of plan termination, is appropriate and practical.

Second, a plan sponsor's immediate liability to fund vested benefits is triggered under ERISA section 4062(e) *only if* more than 15% of the *active and eligible* plan participants are terminated, most commonly due to a plant closing or mass layoff. However, this protects workers only and the PBGC has no similarly strong leverage to seek funding in potentially worse situations that endanger retirees, such as when a plan sponsor transfers a substantial pension liability to a weak spin-off, or retains all of the pension liability while spinning off very valuable and profitable portions of the company needed to cover future contributions.

Third, the PBGC needs to expand the scope of transactions it scrutinizes under its Early Warning Program. The agency currently monitors roughly 1,100 companies with more than $50 million in underfunding, or which have below-investment grade bond ratings and under-funding in excess of $5 million. In addition, the PBGC monitors notifications of a wide range of "reportable events" (see above), some of which are provided in advance. However, it does not appear that the PBGC routinely monitors and reviews in advance three types of transactions that expose the agency and retirees to potentially greater risk of loss: spin-offs (whether or not pension liabilities are transferred), acquisitions of plan

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[54] *See* PBGC, "PBGC's Guarantee Limits: An Update," Sept. 2008, at p. 9, available at https://www.pbgc.gov/documents/guaranteelimits.pdf. *See also* NRLN, "Pension Guarantees that Work for Retirees," White Paper Series, *updated* Sept. 2017, at pp. 7-10. PBGC has not publicly released updated data on vested benefits lost due to distress terminations.

[55] NRLN, "Protecting Retiree Benefits in Bankruptcy," White Paper Series, *updated* Sept. 2017.

sponsors by non-U.S. firms (whether in whole or in substantial part), and intra-firm plan mergers, particularly those that follow M&A activity and combine pension plans with divergent funding levels.

Fourth, the PBGC (and retirees) have a very limited ability to either attach or enforce a lien against the tangible assets of a contributing plan sponsor or other named fiduciary located outside the jurisdiction of the U.S. federal courts. It is not even clear that the PBGC can enforce a lien against other U.S.-based assets or subsidiaries of a foreign company that are not part of the plan's controlled group.

Finally, ERISA's current and proposed definition of who is potentially liable as a plan "fiduciary" will prove meaningless in a growing number of situations where plan participants, the Department of Labor and PBGC will be unable to hold certain non-U.S. fiduciaries accountable even for knowing and willful breaches of fiduciary duty that deplete plan assets. It is an empty exercise to determine that an individual or firm is an ERISA fiduciary and liable for a breach of fiduciary duties if that party is not subject to the jurisdiction of U.S. courts.

A. PBGC Needs Remedies Other than 'Nuclear Option' of Involuntary Termination

As explained above, one of the PBGC's few tools to intervene in a spin-off or other M&A transaction that threatens the long-term solvency of the pension plan is to threaten to seek a federal court's approval to initiate an involuntary termination of the plan, making the plan sponsor immediately liable for any under-funding. Since the PBGC calculates this liability as if the present value of every future pension payment had to be paid immediately (and not offset by future investment returns on plan assets), an ongoing plan that is 85% funded under ERISA standards may be 60% funded on a PBGC termination basis. If the PBGC can credibly convince a court that an involuntary termination is justified to prevent an even larger loss down the road, the prospect of this immediate liability is in some cases enough to convince the company to negotiate additional contributions or guarantees (e.g., bonds or liens on tangible assets). And, as noted above, the PBGC has demonstrated success in winning concessions that protect retiree benefits when it is aggressive in leveraging ERISA section 4042(a)(4).

The problem is that section 4042(a)(4) authorizes only a "nuclear option" – immediate, involuntary plan termination – that is of limited utility for preventing a spin-off or other material transaction from undermining the long-term solvency of a pension plan. This is true for a number of reasons:

First, and most significantly, the PBGC is limited to asking the court to approve termination. In a series of exit memos suggesting needed reforms, former PBGC Executive Director Bradley Belt argued the agency needed the sort of authority a bank regulator or the Securities and Exchange Commission has to seek remedies short of the "nuclear option" – options that help rather than harm plan participants. These options include a cease and desist order, a cash contribution, or a lien on tangible assets that could reduce under-funding if the firm declares bankruptcy. "PBGC's primary authority in this regard is to initiate plan termination, which we have used effectively, but which is also a very blunt instrument that can result in a high-stakes game of brinksmanship," Belt wrote. "Other government or Congressionally-chartered entities that provide a financial guaranty, particularly the FDIC, but also OPIC, Ex-Im Bank, and SIPC, have a much broader tool set at their disposal to avoid losses and manage risks than does the PBGC."[56]

Second, because of the statutory language, the PBGC's threat of a possible involuntary termination is not credible unless it is prepared to persuade a federal judge that the plan's "possible long-run loss" is "reasonably expected to increase unreasonably if the plan is not terminated."[57] This is a high bar that the

[56] Bradley Belt, "Look Ahead, Part IV – Longer-Term Strategic and Structural Issues," Memorandum to the PBGC Board of Directors (May 30, 2006), at p. 4.
[57] ERISA § 4042(a)(4).

PBGC has made even higher by adopting an internal policy that it should not proceed in such cases unless it is "highly likely" that the plan will end up in a distress termination. In practice, it seems to require (as in the recent examples noted above) that the plan is both under-funded *and* that the ongoing profitability of the corporate entity responsible for future contributions is very suspect.

Third, the PBGC's negotiating posture is further weakened because companies know that the agency's only option – terminating the plan – is an action it typically takes only as a last resort. When a plan is terminated, current employees stop accruing additional pension credits; and retirees, particularly early retirees and those with benefits in excess of the PBGC guarantees, can permanently lose benefits. In addition, the PBGC would not only need to take over plan administration, but also begin a protracted legal battle to recover as much of its inflated estimate of the plan's "termination liability" as possible, which in some cases might even help to push a firm into bankruptcy and cost more jobs. One result is that even companies such as Motorola and Bello, which agreed to make additional contributions to reduce current under-funding, may have agreed or been forced by the court to make larger concessions if the PBGC could seek remedies short of termination.

Fourth, even if the PBGC calls the company's bluff and goes to court, a judge will be more reluctant to rule in its favor – over the company's objections – when the only option is an involuntary termination that the court knows will impose permanent losses on many plan participants and impact the government by adding to the PBGC's reported deficit.

Finally, as a practical matter, neither the Early Warning Program nor the section 4042(a) "nuclear option" reach transactions such as the strategic sale or spin-off of under-performing divisions or subsidiaries by financially healthy firms. A classic example is Verizon's 2006 spin-off of its declining Yellow Pages unit into a new public company called Idearc that entered bankruptcy less than three years later. As Verizon and its competitors made Internet access ubiquitous, it was clear even then that printing and delivering five-pound piles of paper free to every home was a business living on borrowed time. But while spinning off its Yellow Pages unit made business sense, it was likely a breach of fiduciary duty to load onto that sinking ship the liability for vested benefits earned many years earlier by 2,000 Verizon retirees.

Unfortunately, because Verizon's pension plan at the time was fully funded – and the company is not financially weak – this increasingly common brand of strategic spin-off does not fall within the scope of the PBGC's Early Warning Program. And even if it did, it may have been difficult to convince a court that a fully-funded Verizon spin-off was highly likely to end up in bankruptcy any time soon. But bankruptcy is where Idearc landed; and although the company emerged from bankruptcy with a new name (SuperMedia) and its pension plan intact, the former Verizon retirees ultimately lost a three-year court battle to recover lost health and welfare benefits through a class action suit supported by the Association of BellTel Retirees.[58]

Regulators need the ability to temporarily enjoin a spin-off or other M&A activity and convince a court that a more tailored remedy, short of plan termination, is appropriate and practical. Like a bank regulator or commercial creditor addressing a heightened risk of insolvency, the PBGC should be able to negotiate with a plan sponsor with the leverage of knowing that it can go into federal District Court and seek approval for remedies short of plan termination. These would not be novel remedies for a regulatory agency – and could permit a court-approved outcome more tailored to the risk of increased loss to the PBGC (and to retirees). The remedies could include a cease and desist order, a schedule of contributions that restore full funding or, most usefully, warrants or other secured obligations (such as liens on tangible assets) equal to the current or projected termination liability shortfall. The PBGC should be able to

[58] The history and links to court filings in the class action suit are available at https://belltelretirees.org/idearc-bankruptcy-litigation/.

request court approval for liens on terms equivalent to the statutory liens that ERISA imposes when a plan sponsor refuses or fails to pay plan termination liability under Section 4062.[59]

If in fact the spin-off or other transaction does not lead to a distress termination within a certain number of years, the guarantees would expire and the parties would be no worse off. But if in fact the spun-off division – or the shell of a parent left behind – end up filing for bankruptcy and a distress termination of their pension obligations, both the PBGC and the retirees and other participants would be better protected against loss.

Finally, even if the PBGC is given more flexibility to protect workers and retirees when a transaction appears likely to result in greater underfunding and a distress termination, the Department of Labor (DOL) should become far more pro-active in exercising its obligation to enforce ERISA's fiduciary duty requirements. ERISA requires that plan sponsors and other fiduciaries administer the plan "solely in the interests of plan participants and beneficiaries."[60] Failure to do so can lead to liability for a breach of fiduciary duty.[61] And although plan sponsors wear two hats – and are not held to the fiduciary standard of care when acting as the "settlor" of the plan (e.g., when amending, freezing or terminating plans for business-related economic reasons) – firms can violate ERISA if they knowingly structure a transaction in a manner likely to result in a failure to pay promised (vested) benefits.

A classic example of a spin-off that resulted in liability for a breach of fiduciary duty upheld by the U.S. Supreme Court occurred in *Varity Corp. v. Howe.*[62] Varity, a Canadian conglomerate, moved several of its money-losing business lines, including U.S. subsidiary Massey-Ferguson, into a single new subsidiary, Massey Combines Corporation. The spin-offs included pension plans for 1,500 active workers and 4,000 retirees. The workers were told that their benefits would remain secure, even though internal communications showed management knew that the spin-off's chances of avoiding bankruptcy were not good.

Less than two years after the spin-off, Massey Combines filed for bankruptcy and canceled health and welfare benefits that were maintained at Varity, the Canadian parent. Workers and retirees sued, alleging that Varity had breached its fiduciary duty by misleading plan participants about the likely consequences of the spin-offs and by knowingly including their benefit obligations in a spin-off they knew was likely to go bankrupt. The federal District Court found that Varity purposely structured the transaction to offload debt and ongoing liabilities, including "the unlawful purpose of jettisoning its obligation to pay retirement

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[59] Part 4068 of the PBGC's regulations provides that if a plan sponsor "fails or refuses to pay the full amount of such [termination] liability within the time specified in the demand letter issued under § 4068.3, the PBGC shall have a lien in the amount of the liability, including interest, arising as of the plan's termination date, upon all property and rights to property, whether real or personal, belonging to that person, except that such lien may not be in an amount in excess of 30 percent of the collective net worth of all persons described in section 4062(a) of ERISA and part 4062 of this chapter." 29 C.F.R.Part 4068–Lien for Liability, available at https://www.law.cornell.edu/cfr/text/29/part-4068.

[60] ERISA §404(a)(1)(B).

[61] ERISA §502(a)(2) authorizes the Secretary of Labor, participants, beneficiaries, and fiduciaries to obtain "appropriate relief" under section 409 for violations of fiduciary responsibilities. ERISA § 502(a)(3) allows a participant, beneficiary, or fiduciary to obtain "any other appropriate relief."
to redress violations."

[62] *Varity Corp. v. Howe*, 116 S. Ct 1065 (1996).

and disability benefits."[63] The Supreme Court upheld the lower courts' rulings against Varity, concluding that the company had a fiduciary duty not to knowingly mislead plan participants.[64]

As the Varity case indicates, DOL needs to become far more pro-active in scrutinizing potential liability for breach of fiduciary duty in the context of transactions that transfer, or leave behind, pension and other benefit liabilities in a manner likely to lead to termination or default. DOL should coordinate closely with the PBGC, which is already expending substantial resources to monitor and winnow possible violators under its Early Warning Program. DOL should also put a higher priority on investigating complaints filed by workers and retirees who believe that an impending spin-off or other transaction, such as Verizon's spin-off of its Yellow Pages subsidiary noted just above, has the intent or likely result of leading to a distress termination and lost benefits.

B. The 15% Threshold Under § 4062(e) Should be Broadened to Protect Retirees

As described in the previous section, the partial termination liability triggered by major plant closings or mass lay-offs under Section 4062(e) allows the PBGC to shore up the funding of impacted plans to some degree. However, while useful, the statutory provision is far too narrow, leaving retirees and other participants who are negatively impacted by corporate restructurings or changes in ownership unprotected if liabilities are transferred without a sufficient transfer of assets.

The biggest gap in the protection provided by ERISA's "cessation of operations" provision is its failure to trigger liability for under-funding in the context of a range of other transactions that often pose even greater risk to *all* plan participants, the vast majority of which are often retirees and not active workers. These include not merely substantial downsizings, but also spin-offs, control group break-ups and takeovers by foreign firms largely beyond the reach of the PBGC and ERISA fiduciary enforcement. Although Section 4042(a)(4) provides the PBGC with some limited leverage in these situations, that provision is similarly narrow and subject to many limitations discussed in the previous section.

Although plant closing and resulting mass lay-offs were the foremost threat Congress had in mind at the time it added the protection in § 4062(e), today the threat of restructuring can be equally devastating to retirement security and the ability of PBGC to ward off a taxpayer-funded bailout. For example, the transfer of more than 15% of the liabilities of a pension plan to a different controlled group – including through a spin-off or takeover – should similarly trigger immediate liability to ensure full funding of the transferred benefit liabilities. This would also fill the gap left by Internal Revenue Code Section 414(l) which, as noted in the section above, exempts plan liabilities transferred to "an employer who is not a member of the same controlled group as the employer maintaining the original plan."[65]

An updated trigger should also address the converse threat: that a plan sponsor will spin-off the firm's most productive and profitable division(s), leaving the legacy pension obligations (or a disproportionate share of them) behind in a likely-to-fail shell company. Recall that this was the PBGC's concern when Motorola announced that it would spin-off its mobile handset business into a new company ("Motorola Mobility"), and sell it to Google, but leave all pension liabilities with the original company ("Motorola Solutions"), which would have less revenue to support contributions to the already under-funded plan. To avoid this loophole, the transfer of 15% or more of a plan sponsor's assets or revenues to a different

[63] Howe v. Varity Corp., 1989 WL 95595, at *6 (S.D. Iowa July 14, 1989).
[64] The Court also held for the first time that employees could sue as individuals and seek equitable relief for a breach of this fiduciary obligation. *Id.* at 1079. Before this, an individual could sue only as a representative of the plan.
[65] I.R.C. § 414(l)(2)(D)(ii).

controlled group – including through a spin-off or sale – should similarly trigger immediate liability to ensure the full funding of the plan's vested benefit liabilities.

It's important to note that like the current "cessation of operations" provision, the PBGC can use its authority to negotiate additional contributions and/or other guarantees (such as an escrow account, bond or liens against tangible assets) to satisfy the plan sponsor's liability. The PBGC has no incentive to seek immediate payment of the full amount of under-funding if that would result in a bankruptcy or distress termination. Instead, as it does today under both § 4062(e) and § 4042(a)(4), the agency would be able to leverage the company's potential liability for immediate under-funding to negotiate protections for plan participants and taxpayers alike.

C. Spin-Offs and Foreign Acquisitions Need Review Under Early Warning Program

Under its Early Warning Program, the PBGC currently monitors about 1,100 companies which it screens on the basis of significant underfunding (more than $50 million), or because of a combination of financial weakness (below-investment grade bond ratings) and under-funding in excess of $5 million. In addition, the PBGC also monitors notifications of a wide range of "reportable events" (see above), some of which are provided in advance, although these are required from public companies only 30 days *after* a transaction. However, it does not appear that the PBGC routinely monitors and reviews in advance three types of transactions that expose the agency and retirees to potentially greater risk of loss: spin-offs (whether or not pension liabilities are transferred) and acquisitions, takeovers or mergers of a U.S. plan sponsor by a non-U.S. firm (whether in whole or in substantial part), and intra-firm plan mergers.

It's clear from the many examples described above that certain corporate transactions – particularly the spin-off of under-performing subsidiaries – are likely to increase the long-term risk of distress termination and benefit loss for retirees transferred in the deal. Strategic spin-offs of under-performing units holds even greater appeal when legacy pension, health and welfare benefits can be taken off the books of the parent company. Almost any announced spin-off, split-up or sale of a division by a U.S. company with legacy defined-benefit liabilities should send up a bright red warning flare that the retirees (and possibly American taxpayers) will end up subsidizing the transaction if the now stand-alone unit deteriorates into bankruptcy.

While the PBGC will quickly determine that the majority of mergers, acquisitions, spin-offs and takeovers will not adversely impact a defined-benefit plan, it will also certainly identify additional major transactions each year that will deserve closer scrutiny. However, particularly in cases where no pension liabilities will be transferred along with the spin-off, it will be equally important for the PBGC to review – as the agency did with Motorola's split-up late last year – whether the parent is being hollowed out and left with a weakened ability to support the legacy pension benefits left behind.

Similarly, while it will certainly prove true that the vast majority of foreign acquisitions and takeovers of U.S. firms do not negatively impact the future solvency of the pension plan, any potential transfer of pension liability to a non-U.S.-based plan sponsor should be reviewed under the Early Warning Program. In addition to the concerns associated with any change in corporate structure or ability to support the plan, is the added risk that a particular foreign acquirer is effectively beyond the reach of the PBGC and of U.S. courts with respect to any future liability for a distress termination or breach of fiduciary liability. As the PBGC discovered in the case of Daimler's ownership of Chrysler, the risk profile is far different for a company (like Daimler) that has extensive tangible assets under the jurisdiction of U.S. courts than it would be for a company that has few if any other U.S.-based assets that the agency (or participants) could attach a lien against in an effort to mitigate the financial loss from an abandoned plan or fiduciary breach.

D. Plan Sponsors Can Escape Liability Outside the Jurisdiction of U.S. Courts

As globalization and the acquisition of American companies by foreign firms and investors become increasingly common, there is growing concern about the PBGC's ability to deter plan terminations by, or recover assets from, foreign-owned or foreign-based plan sponsors. As a legal matter, ERISA makes no distinction between U.S. and foreign-based companies with respect to a plan sponsor's funding obligation, fiduciary duty and potential liability for vested benefits. The foreign-based parent of a U.S. subsidiary that sponsors a pension plan is part of a plan's "controlled group" and subject to precisely the same obligations and scrutiny as U.S.-based companies.[66] As a result, under ERISA every member of a plan's "controlled group" is jointly and severally liable for funding shortfalls if a plan is terminated, as well as for required minimum funding contributions while the plan is ongoing.[67] If a pension plan is terminated, and the liability for unfunded benefit obligations owed to the PBGC is not paid on demand, a statutory lien arises and is imposed on the property of the plan sponsor and its controlled group.[68]

However, as a practical matter, although ERISA treats a U.S.-based subsidiary and its foreign parent as jointly and severally liable, the PBGC has had great difficulty persuading either U.S. or foreign courts to attach or to enforce a lien against the assets of a plan sponsor outside the territorial jurisdiction of the U.S. Actually, collecting on a liability in practice requires that the foreign entities have sufficient assets within the jurisdiction of U.S. courts.

The PBGC has stated that to date there have been few serious problems with a foreign company successfully evading its pension obligations and shielding itself from enforcement overseas. Nevertheless, PBGC and Treasury Department lawyers concede that it is not clear whether U.S. courts could or would enforce a lien against the assets of a plan sponsor (or a plan sponsor's foreign parent) located outside U.S. territory. For example, prior to the transfer of Chrysler assets, the PBGC perfected liens against the U.S.-based assets of Daimler, a German company. This served to put pressure on Daimler to negotiate pension funding levels. However, PBGC believes it would have needed the cooperation of the German government to enforce liens against Daimler assets in Germany. Thus, in practice, actually collecting on a liability requires that the foreign entities have a U.S. presence and sufficient assets within the jurisdiction of U.S. courts.

To date, the PBGC has not fared well in the courts. Before the PBGC (or plan participants) can even seek to enforce a judgment, it must first convince a U.S. court that it has personal jurisdiction over the foreign parent or other allegedly liable foreign fiduciary. In *GCIU-Employer Retirement Fund v. Goldfarb Corp.*, the Seventh Circuit Court of Appeals rejected the PBGC's attempt to proceed in federal court to collect withdrawal liability against the Canadian parent (Goldfarb) of a U.S. subsidiary.[69] The Court ruled that the foreign parent did not have sufficient contacts with the U.S. to confer personal jurisdiction on a U.S. court. The court emphasized that the parent was based in Canada and did not maintain a place of business, employ individuals, serve customers, or have a designated agent for service of process inside the U.S.

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[66] A company's "controlled group" includes its parent, and other subsidiaries of the parent, provided that an 80% ownership test is satisfied. ERISA §414(b) defines a controlled group as a combination of two or more corporations that are under common control within the meaning of "controlled group" as defined generally in 26 U.S.C. § 1563 (2009). The relationship between members of the "controlled group" is typically parent-subsidiary or brother-sister subsidiaries (controlled by the same parent owning 80% or more of each).

[67] ERISA §4062, 29 U.S.C.A. §1362 and ERISA §302(c)(11), (f)(5), 29 U.S.C.A. §1082(c)(11), (f)(5), respectively.

[68] ERISA §4062(a), 29 U.S.C.A. §1368(a). This federal tax lien is in an amount equal to the lesser of the unfunded benefit liability or 30% of the collective net worth of the controlled group, as determined 29 U.S.C.A. §1362(d)(1)(c).

[69] *GCIU-Employer Retirement Fund v. Goldfarb Corp.*, 565 F.3d 1018 (7th Cir. 2009).

To its credit, the PBGC has at times been aggressive in pursuing claims against the foreign parent of U.S. subsidiaries that walk away from their underfunded pension obligations. In November 2010, the PBGC filed a $175 million claim against Asahi, the Japanese parent of Metaldyne, a wholly-owned U.S. subsidiary that terminated a substantially under-funded plan.[70] The PBGC's claim states that as part of the plan sponsor's controlled group, Asahi is jointly liable for the total underfunding related to the termination of the Metaldyne pension plan, as well as the PBGC's litigation costs in connection with recovery of those liabilities. Once again, a U.S. court can only adjudicate pension-related claims against a foreign company like Asahi if it has personal jurisdiction because of the company's activities in the U.S. As one leading U.S. law firm stated, "if a foreign defendant does not have sufficient contacts with the United States, the case will be dismissed. Meeting this requirement is one of the key impediments to any PBGC claim in a U.S. court against a foreign member of a controlled group."[71]

The PBGC has reported on several futile attempts to collect plan termination liability from the under-funded and bankrupt subsidiaries of foreign-based firms. For example, in 2011 the PBGC filed suit against Bendix, an auto systems manufacturer and wholly-owned subsidiary of a German company (Knorr-Bremse AG), that flatly refused to pay the termination liability associated with its shutdown of a brake compressor plant in Kentucky (which it moved to Mexico).[72] Although the PBGC was able to settle the Bendix litigation in 2012, if the subsidiary and/or its German parent did not have substantial U.S.-based assets, the PBGC and the company's workers and retirees may suffer a permanent loss. Similarly, in March 2011, the PBGC initiated an involuntary termination of the pension plan at another German-owned U.S. affiliate because the parent company (Bowe Systec, AG) was liquidating and the affiliate's U.S. plan was only 50% funded.[73]

This problem is of growing concern to retirees because of the size of some foreign acquisitions and the potential insulation of the foreign parent from full liability. For example, in 2006 Lucent Technologies, which supports one of the largest U.S. pension plans, was acquired by Alcatel SA, a French company. Lucent became Alcatel-Lucent USA, one of three wholly-owned subsidiaries of the French parent. And although the French parent had effective control over the pension trust, it is not clear if parent company assets outside the jurisdiction of U.S. courts could be reached in case of a distress termination.

Even if the PBGC or a plan participant prevails on these jurisdictional issues and wins a monetary judgment in U.S. federal court, enforcing it in a foreign court faces high hurdles. As an agency of the U.S. government, the PBGC in particular faces a number of roadblocks to collecting on an ERISA claim in a foreign court. "For example, the success of a claim in a foreign court could hinge on such court's recognition of US laws (under principles including Comity, which is the acceptance of laws of a court of another jurisdiction), and related exceptions (*e.g.*, "revenue rule," the "public law" exception, tax treaties, etc.) and, further, the US and foreign courts' analyses of the extraterritorial reach of ERISA."[74]

The PBGC takes the position, correctly, that all members of a controlled group, including subsidiaries located completely outside the U.S., are treated under ERISA as jointly and severally liable for pension benefit liability.[75] However, according to the PBGC's former General Counsel, ERISA is not explicit – and it has not been tested in a U.S. court – whether PBGC liens against *other* U.S.-based assets or

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[70] Complaint, *PBGC v. Asahi Tec Corp.*, No. 10-cv-01936 (District Court, D.C., filed November 12, 2010).
[71] Latham & Watkins Tax Department, "Asahi: The PBGC's Continued Attack on Non-US Controlled Group Members," *Client Alert* No. 1122 (January 18, 2011).
[72] "PBGC Tells Bendix to Pay $16.9 Million in Pension Debt," PBGC News Release No. 10-23, February 04, 2010.
[73] "PBGC to Pay Pension Benefits at Böwe Bell + Howell Co.," PBGC News Release No. 11-27, March 17, 2011.
[74] Latham & Watkins Tax Department, "Asahi: The PBGC's Continued Attack on Non-US Controlled Group Members," *Client Alert* No. 1122 (January 18, 2011), at p. 3.
[75] *See* PBGC, Opinion 97-1 (May 5, 1997).

subsidiaries of a foreign company, which are outside the controlled group sponsoring the pension plan, would be enforced by either a U.S. or foreign court. For example, the foreign parent of a U.S. subsidiary could have other unrelated assets or subsidiaries located within the jurisdiction of U.S. courts. With respect to reaching the overseas assets of a foreign-based company that defaults on pension funding, it's unlikely that the foreign courts would apply U.S. law unless there is a bilateral treaty in effect. While the U.S. maintains many bilateral treaties with countries with similar interests in mutual law enforcement, that is a major undertaking unlikely to occur for such a narrow purpose within the foreseeable future.

Because of this increased risk, **Congress needs to clarify that the PBGC has the authority to enforce a lien against all U.S.-based assets of a foreign-based plan sponsor, even if those other subsidiaries or assets are not considered part of the "controlled group" sponsoring the plan.**

E. Named Fiduciaries Can Escape Liability Beyond the Jurisdiction of U.S. Courts

The enforcement of ERISA's fiduciary duty rules is at the heart of the Department of Labor's mission to safeguard retirees' pension assets and promised benefits. ERISA Section 409(a) imposes liability on a breaching fiduciary to (i) make restitution to the plan for losses resulting from the breach; (ii) disgorge profits obtained by the fiduciary as a result of the breach of duty; and (iii) be subject to other equitable or remedial relief deemed appropriate by the court, including removal of the fiduciary. ERISA Section 409(a) also provides for the personal liability of fiduciaries, stating in part:

> Any person who is a fiduciary with respect to a plan who breaches any of the responsibilities, obligations, or duties imposed upon fiduciaries by this title shall be personally liable to make good to such plan any losses to the plan resulting from each such breach, ...[76]

This strict standard of accountability is negated if a company or person can act as a fiduciary with respect to the administration or control of plan assets while remaining immune from the judgment of a U.S. court even for knowing and willful breaches of fiduciary duty that deplete plan assets. Many American firms have been acquired by or merged with foreign entities, putting the pension plan under the effective control of a non-U.S.-based parent. As a result, an increasing number of foreign-based entities are "named fiduciaries," as defined by Section 402 of ERISA, with respect to control or management of the assets of the plan, as well as the designation of other subordinate fiduciaries.

ERISA Section 404 defines the duties of a fiduciary and is arguably the best guide to Congressional intent concerning the risks and abuses that could undermine plan benefit security. Accordingly, Section 404(b) states:

> Except as authorized by the Secretary by regulation, no fiduciary may maintain the indicia of ownership of any assets of a plan outside the jurisdiction of the district courts of the United States.

By regulation, DOL has generally taken pains to ensure that plan "assets are under the management and control of a fiduciary which is a corporation or partnership organized under the laws of the United States . . . [and] has its principal place of business within the United States and which is" a bank, insurance company or registered investment adviser under U.S. regulation and with substantial net worth or equity.[77] Where a foreign entity, such as a foreign securities depository, holds the indicia of ownership,

[76] 29 U.S. Code § 1109(a).
[77] 29 C.F.R. §2550.404(b)-1(a).

DOL regulations require that it does so only as an agent for the U.S. bank or other entity that is subject to the jurisdiction of U.S. district courts, which in turn remains "liable to the plan to the same extent it would be if it retained the physical possession of the indicia of ownership within the United States."[78]

However, although Congress in 1974 clearly anticipated the need to keep plan *assets* under the jurisdiction of U.S. district courts, there remains a gap in EBSA's regulations concerning the ability to hold plan fiduciaries liable for *missing assets – viz.*, for the enforcement of judgments against named or other fiduciaries to recover losses due to a breach of fiduciary duty that typically leave a plan more under-funded (on a termination basis) than it otherwise would have been. While plan assets must remain subject to the jurisdiction of U.S. courts, ERISA regulation neglects to do the same with respect to the liability of plan fiduciaries for the recovery of plan assets lost due to a fiduciary breach.

Section 502(a)(3) of ERISA provides that a civil action may be brought by a participant, beneficiary or fiduciary to recover benefits, to enjoin any act or practice which violates Title I or the terms of the plan, or to obtain any other appropriate equitable relief to redress a fiduciary breach. In general, this private right of action has greatly benefited plan participants, resulting in well over 1,000 fiduciary lawsuits in U.S. court and no doubt deterring countless more.[79] But unless DOL updates its rules to ensure that ERISA fiduciaries subject themselves to the jurisdiction of U.S. courts, in an increasing number of cases plan participants will have no effective remedy vis-a-vis foreign fiduciaries in the American court system. It is an empty exercise to determine that an individual or firm is an ERISA fiduciary and liable for a breach of ERISA fiduciary duties if that party is not subject to the jurisdiction of U.S. courts.

Plan participants also rely on DOL enforcement both for actual financial recoveries and for its wider deterrent effects. EBSA reports its many fiduciary enforcement actions on the Department of Labor website.[80] As part of its stepped-up enforcement program, EBSA has filed as many as 24 lawsuits against fiduciaries in a single day.[81] Effective jurisdiction over breaching fiduciaries is also essential for the recovery of assets by the PBGC in the aftermath of a distress termination, which frequently results in the agency pursuing a bankrupt plan sponsor and/or controlled group members to recover unfunded pension liabilities. Even a judgment in favor of the agency, or of plan participants, which orders restitution or the disgorgement of ill-gotten profits, could generally not be enforced against a fiduciary without sufficient assets under the jurisdiction of U.S. courts.

IV. Policy Recommendations to Protect Retirees and Limit PBGC Losses

The five gaps in protections for retirees described just above will grow wider each year as both globalization and corporate financial engineering continues apace. The economic environment is very different – and far more dangerous for retirement security – than it was in the 1970s or 1980s when ERISA was adopted and first refined. While it is important not to impede the increased productivity and efficiencies that result from the majority of corporate transactions and restructurings, it is equally important to update the rules of the road to ensure that plan sponsors and fiduciaries do not abuse gaps in

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[78] 29 C.F.R. §2550.404(b)-1(a)(2)(ii)(C).

[79] *See, e.g.,* Robert N. Eccles, "Fiduciary Litigation Under ERISA," O'Melveny & Myers LLP, Washington, D.C., BNA Books, reprinted with permission (Apr. 15, 2004).

[80] EBSA, Criminal Enforcement News Releases, available at http://www.dol.gov/ebsa/newsroom/criminal/main.html

[81] Robert Stowe England, "Labor Department Gets Tough," *Human Resource Executive Online*, Nov. 19, 2010, available at http://www.hreonline.com/HRE/story.jsp?storyId=533325938.

the law and in enforcement to deny retirees and workers any part of their earned pension benefits, or to transfer a share of those losses onto the PBGC.

The following five recommendations for legislation, regulatory reform and stepped-up enforcement activity seek to narrow the gaps in protections for retirees described in the sections above:

1. *Broaden the Remedies Available for Transactions that Risk Termination Under § 4042(a)*

The PBGC's authority to seek additional plan contributions, guarantees or other remedies under ERISA section 4042(a) is too limited. **Congress should give the PBGC needs more flexible authority under section 4042(a) to negotiate or seek court approval for a more tailored remedy, short of plan termination, to address spin-offs or other corporate transactions that greatly increase the risk of future loss to the PBGC or to plan participants.**

Section 4042 should be amended so that in addition to initiating a distress termination, the PBGC and the Department of Labor would also have the sort of authority a bank regulator or the Securities and Exchange Commission has to seek remedies short of the "nuclear option" of involuntary plan termination – options that would help rather than harm plan participants. These more modest and tailored remedies should include an increase in plan contributions, or a bond or lien on tangible assets, that could help pay benefits if the firm declares bankruptcy and abandons its plan in the future. In tandem, the Department of Labor should more pro-actively investigate complaints from participants, or referrals from PBGC, concerning transactions that potentially trigger liability for breach of fiduciary duty.

More specifically, **the NRLN proposes that Congress amend ERISA by adding the following new subclause (4) to § 4042(c) [29 U.S. Code § 1342(c)]**:

> **(c) ADJUDICATION THAT PLAN MUST BE TERMINATED**
>
> . . .
>
> (4) In the case of a proceeding initiated under this section, the corporation shall have the discretion to propose a remedy that does not require the termination of the plan if the United States district court agrees that such alternative remedy will better protect the interests of the participants or avoid any unreasonable deterioration of the financial condition of the plan. The alternative remedies considered by the corporation can include, but are not limited to, supplemental plan funding contributions, the furnishing of a bond as surety, and the imposition of liens on tangible assets of any contributing sponsor of the plan or a member of such contributing sponsor's controlled group.

2. *Broaden the Events Triggering PBGC Discretion to Seek Termination Under § 4042(a):*

The "substantial cessation of operations" provision under ERISA section 4062(e) is triggered *only if* more than 15% of the *active and eligible* plan participants are separated from the plan, most commonly due to a plant closing or mass layoff. This protection is far too narrow, leaving retirees and many other participants negatively impacted by spin-offs or other corporate restructurings unprotected.

The events that authorize the PBGC to initiate proceedings to terminate a plan under Section 4042(a), or to seek an alternative remedy (as proposed just above), should be expanded to include spin-offs, controlled group break-ups or takeovers by foreign firms that transfer 15% or more of the plan's liabilities without the transfer of commensurate and sufficient assets.

Accordingly, the NRLN proposes that Congress amend ERISA by adding the following new subclause (4) to § 4042(a) [29 U.S. Code § 1342(a)]:

> **(a) Authority to institute proceedings to terminate a plan**
> The corporation may institute proceedings under this section to terminate a plan whenever it determines that—
>
> . . .
>
> > **(4) the reportable event described in section 1343(c)(12) of this title has occurred and an aggregate of 15 percent or more of the benefit liabilities of such plan are transferred without the transfer of commensurate and sufficient assets, or**
> >
> > **~~(4)~~(5) [renumbered]**

Where plan sponsors credibly demonstrate that immediate payment of the under-funding liability is impractical or could disrupt the company, the PBGC – as it does currently under Section 4062(e) – can negotiate agreements to amortize payments and/or accept a guarantee (such as an escrow account or a bond backed by tangible assets) that would cover the liability if the plan terminates within 5 years.

3. *PBGC's Early Warning Program Must Review Sales to Non-U.S. Firms and Plan Mergers*

The PBGC should add intra-firm plan mergers and proposed spin-offs or transfers of pension liabilities to foreign owners to the list of transactions triggering special scrutiny under the PBGC's Early Warning Program and, if possible, to the list of transactions requiring an Advance Notice of Reportable Events. As the list of reportable events suggests (see above), nearly every other significant change in corporate structure, or in the controlled group contributing to a plan, is subject to Risk Mitigation Program reporting *except* foreign acquisition.

Accordingly, the NRLN proposes that Congress amend ERISA Sections 1343(b) and 1343(c) so that **all proposed transfers or spin-offs of pension assets or liabilities to a foreign controlled group or entity, and all mergers of two or more qualified plans, should be included among the transactions that require an Advance Notice of Reportable Events to PBGC.** A new subclause (13) should be added to Section 1343(c), providing:

> **(c) Enumeration of reportable events**
> For purposes of this section a reportable event occurs—
>
> . . .
>
> > **(13) [new] when, in any 12-month period, an aggregate of 3 percent or more of the assets or benefit liabilities of a plan covered by this subchapter are transferred to a controlled group or other foreign-based entity that is not subject to the jurisdiction of a Federal District Court**;

More generally, the NRLN believes that all substantial spin-offs, split-ups and takeovers of companies that impact defined-benefit plans should be scrutinized under the PBGC's Risk Mitigation Program (which includes the Early Warning Program). Even if a plan is not substantially under-funded – and even if the company is financially strong overall – it should raise an automatic red flag when a proposed spin-off will separate legacy pension liabilities from some substantial portion of the business divisions generating ongoing revenue to support them. An example of the latter situation – a spun-off division or subsidiary – is Verizon's sale of its under-performing Yellow Pages, discussed above. While it's unclear whether the PBGC reviewed that spin-off – or engaged the company concerning the funding of the pension assets transferred to the new entity – even though Verizon is financially strong and well-funded overall, the fact that the spin-off of a failing unit can fall so quickly into bankruptcy presents a cautionary tale about the incentives that companies have to offload legacy benefits along with declining business lines.

4. *PBGC Must be Able to Enforce Liens Against all U.S.-Based Assets of Foreign Fiduciaries*

Congress should <u>clarify that the PBGC has the authority to enforce a lien for failure to make required contributions against all U.S.-based assets of the parent company of a foreign-owned plan sponsor</u> even if those other assets or subsidiaries are not considered part of the "controlled group" sponsoring the plan.

According to the PBGC's general counsel, ERISA is not explicit – and it has not been tested in a U.S. court – whether PBGC liens against *other* U.S.-based assets or subsidiaries of a foreign company, which are outside the controlled group sponsoring the pension plan, would be enforced by either a U.S. or foreign court. The PBGC has correctly taken the position that all the U.S.-based assets of foreign companies in a controlled group should be subject to liens for non-payment of U.S. pension liabilities. It would strengthen the hand of both the agency and plan participants if Congress would clarify that explicitly under ERISA Section 4068, which gives the PBGC authority to impose liens.[82]

Accordingly, the NRLN proposes that Congress amend ERISA by adding the following new subclause (4) to § 4068(c) [29 U.S. Code § 1368]:

> (c) PRIORITY
>
> . . .
>
> **(4) For purposes of this subsection, the corporation shall have the authority to impose and perfect a lien against any tangible property or assets of the parent corporation or controlling entity of any contributing sponsor, provided that such property or assets are located within the jurisdiction of a United States District Court.**

5. *Fiduciaries Under ERISA Must Be Subject to the Jurisdiction of U.S. Courts*

Pension plan participants as well as the PBGC have the right to sue plan fiduciaries in U.S. courts for breach of fiduciary duty and to recover plan assets.[83] The DOL and PBGC have on many occasions pursued restitution from fiduciaries of pension plans who breached their fiduciary responsibilities, resulting in a loss of plan assets. However, plan fiduciaries who are not U.S. citizens, and who may not even be domiciled on U.S. territory, can be effectively beyond the reach of U.S. courts and eviscerate intended protections in ERISA.

The Department of Labor should revise its regulations related to breaches of fiduciary duty to <u>clarify that fiduciaries under ERISA – at a minimum contributing plan sponsors and "named fiduciaries" – must be subject to the jurisdiction of federal district courts with respect to the enforcement of judgments for potential breaches of fiduciary duty</u>.

[82] ERISA §4062(a), 29 U.S.C.A. §1368(a).

[83] ERISA requires that the employer sponsoring a qualified pension plan identify in plan documents at least one "named fiduciary" (an individual or entity, such as the corporation's directors) with overall fiduciary responsibility for the plan. ERISA Section 401(a)(1), 29 C.F.R. § 2509.75-5. Other persons (or entities) can be fiduciaries for more limited roles or duties, such as asset management or administration.

DOL should clarify that at a minimum all "named fiduciaries," as defined by Section 402 of ERISA, must be:

(1) subject to the jurisdiction of U.S. courts for the purpose of enforcing judgments under ERISA, and

(2) jointly liable for the fiduciary breaches of other fiduciaries who they designate under Section 405(c)(1) and who they know, or reasonably should have known, are not subject to the jurisdiction of U.S. courts for the purpose of enforcing judgments under ERISA.[84]

ERISA's otherwise strict standard of accountability is negated if a person or firm can act as a fiduciary with respect to the administration or control of plan assets while remaining immune from the judgment of a U.S. court. If DOL does not act, Congress should ensure that ERISA fiduciaries, especially named fiduciaries, are subject to the jurisdiction of U.S. courts.

6. *Intra-Firm Pension Plan Mergers Should Require Advance Notice and PBGC Review*

Congress should **<u>require that intra-firm plan mergers are reportable events</u>, as ERISA originally required, <u>that require advance notice and review by PBGC</u>,** particularly if any of the plans are in at-risk status, as NRLN proposes in a separate white paper on *Defined Benefit Pension Plan Mergers*.

<u>Conclusion</u>

Congress can and must take these essential measures to protect U.S. plan participants from the potential permanent loss of vested pension benefits resulting from an increasing number of spin-offs, foreign acquisitions, and other M & A transactions. The global economic environment in recent years has made clear that such transactions will become more prevalent. The PBGC's experience demonstrates that current statutory authority is insufficient to protect plan participants. For these reasons, it is imperative that policy makers address this situation quickly before a series of transactions occur which can severely undercut the PBGC and become an untenable burden on U.S. taxpayers in addition to imposing permanent losses of vested but non-guaranteed benefits on retirees and other plan participants.

[84] *See* Comments of the National Retirees Legislative Network, Definition of Fiduciary Proposed Rule, Employee Benefits & Security Administration, U.S. Dept. of Labor, RIN 1210-AB32, Feb. 1, 2010.