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PBGC's Final Rule on Liability for Facility Shutdowns Affects Downsizing Employers

BY HAROLD J. ASHNER

Downsizing employers should take note of a final rule issued by the Pension Benefit Guaranty Corporation on June 16, 2006, that may make it easier for PBGC to impose liability as a result of the downsizing.[1] The final rule amends PBGC's regulations to create a new method of calculating liability when there is a cessation of operations at a facility under Section 4062(e) of the Employee Retirement Income Security Act. The regulatory amendments are substantially the same as those PBGC proposed in February 2005,[2] with one clarification.

Section 4062(e) consists of a single sentence, one that raises far more questions than it resolves:

> If an employer ceases operations at a facility in any location and, as a result of such cessation of operations, more than 20 percent of the total number of his employees who are participants under a plan established and maintained by him are separated from employment, the employer shall be treated with respect to that plan as if he were a substantial employer under a plan under which more than one employer makes contributions and the provisions of §§ 4063, 4064, and 4065 shall apply.

The statute is confusing because it ties the liability for a cessation of operations to the liability rules that apply when a substantial employer withdraws from a multiple-employer plan. Those liability rules work when there are multiple employers but not when there is a cessation of operations involving only one employer. This article summarizes and analyzes PBGC's final rule establishing a liability formula that is designed to work in this ''one-employer'' context.

Current Law

If an event described in ERISA Section 4062(e) occurs—in simplified terms, if more than 20 percent of a plan's active participants lose their jobs because of a facility shutdown—the statutory language refers the reader to the rules governing the withdrawal of a substantial employer from a multiple-employer plan. A multiple-employer plan is unlike a multiemployer plan in that it is not collectively bargained and is unlike a typical single-employer plan in that it is maintained by at least two unrelated employers. It is, however, considered to be a type of single-employer plan notwithstanding that multiple unrelated employers maintain it.[3]

In the case of a substantial employer (one whose required contributions to the plan for two consecutive plan years out of the last three plan years totaled at least 10 percent of all required contributions to the plan for those years) that withdraws from a multiple-employer plan, ERISA Section 4063 imposes liability on the withdrawing employer. The liability, which repre-

[1] 71 Fed. Reg. 34819. The final rule is available at http://edocket.access.gpo.gov/2006/pdf/E6-9503.pdf.

[2] 70 Fed. Reg. 9258 (Feb. 25, 2005).

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[3] See ERISA §§ 4001(a)(3), (15).

sents the withdrawing employer's share of the plan's total underfunding in the event of plan termination, is to be paid to PBGC and held in escrow in case the plan terminates within five years after the date of the withdrawal.

■ If the plan terminates within five years, the escrowed payment is added to the plan's assets.

■ If the plan is still ongoing at the end of the five-year period, the escrowed payment is returned to the withdrawn employer.

In lieu of making the payment to PBGC, the withdrawing employer may be required to furnish a bond to PBGC in an amount not exceeding 150 percent of the Section 4063(b) liability, with the bond ultimately realized upon or cancelled depending on whether the plan terminates within five years.

The amount of liability under Section 4063(b) is calculated by first determining the total amount of the plan's ''unfunded benefit liabilities'' (based on PBGC assumptions) as if the plan had terminated on the date of the withdrawal. A portion of that amount is then allocated to the withdrawing employer in proportion to that employer's share of the required contributions to the plan for the last five plan years ending before the date of the withdrawal. Thus, the numerator of the allocation fraction is the total of required contributions of the withdrawing employer over the five-year period, and the denominator is the total of all required contributions over that same five-year period.

When there is a Section 4062(e) event involving only one employer, the cross-reference to the multiple-employer rules governing liability for withdrawal simply does not work. The allocation fraction, taken literally, equals one because its numerator and denominator are the same. Yet the employer presumably should not be liable for the full amount of the plan's termination liability based on a drop of just over 20 percent in the number of the plan's active participants. Fortunately, ERISA Section 4063(b) allows PBGC ''to determine [the Section 4063(b)] liability on any other equitable basis prescribed by the [PBGC] in regulations.'' It is under this explicit statutory authority that PBGC issued its June 16, 2006, final rule.

The Regulatory Liability Formula

Under the final rule, the starting point for determining the liability upon the occurrence of a Section 4062(e) event is the plan's ''unfunded benefit liabilities'' (based on PBGC assumptions), determined ''immediately after'' the date of the cessation of operations under Section 4062(e) rather than on the date of any ''withdrawal'' under Section 4063.[4] (The ''immediately after'' language serves to capture any shutdown or similar benefits triggered by the cessation.) That total liability is then multiplied by an allocation fraction.

The allocation fraction is based on a pure ''headcount'' approach: the numerator equals ''the number of the employer's employees who are participants under the plan and are separated from employment as a result of the cessation of operations'' and the denominator equals ''the total number of the employer's current employees, as determined immediately before the cessation of operations, who are participants under the plan.''[5] Thus, if the cessation results in 3,000 of 10,000 active participants being separated from employment, and the total plan underfunding if the plan had terminated immediately after the date of the cessation would be $10 million, the employer's liability under ERISA Section 4062(e), based on the final rule, would be $3 million (3,000/10,000 x $10 million). This formula tracks the approach PBGC has generally applied on a case-by-case basis through its settlement authority.

Public Comments

The February 2005 proposal to adopt this regulatory liability formula attracted several comments. PBGC noted in the preamble to the final rule that the commenters made four major recommendations, asking for:

■ *Clarification of liability calculation.* Clarification on how to determine the denominator of the fraction set forth in the proposed rule for determining employer liability pursuant to ERISA Section 4062(e);

■ *Additional guidance.* Additional guidance on a variety of interpretive issues relating to ERISA Section 4062(e);

■ *Small plan exemption.* A regulatory exemption from ERISA Section 4062(e) liability for small plans (generally, those with fewer than 500 participants); and

■ *Cap on liability.* A cap on liability in the formula for calculating the ERISA Section 4062(e) liability because the proposed formula could lead to unreasonable results.

Clarification of Liability Calculation. Commenters had pointed out that the proposed rule was not entirely clear as to whether the denominator of the liability fraction included only active participants. The final rule clarifies the regulatory language to ensure that only those participants who are ''current'' employees (determined immediately before the cessation of operations) are included, and the preamble explains that the denominator ''does not include all participants in the plan, such as retirees and other former employees who separated from employment before the cessation of operations.''[6] For good measure, PBGC added the following example to the regulatory text:[7]

> *Example.* Company X sponsors a pension plan with 50,000 participants of which 20,000 are current employees and 30,000 are retirees or deferred vested participants. On a PBGC termination basis, the plan is underfunded by $80 million. Company X ceases operations at a facility resulting in the separation from employment of 5,000 employees, all of whom are participants in the pension plan. A section 4062(e) event has occurred, and the PBGC will determine the amount of employer liability under section 4063(b) of ERISA. The numerator . . . is 5,000 and the denominator . . . is 20,000. Therefore, the amount of liability under section 4063(b) of ERISA pursuant to section 4062(e) is $20 million (5,000/20,000 x $80 million).

Additional Guidance. The simplicity of the regulatory liability formula assumes that it is easy to determine the occurrence of a Section 4062(e) event, its date, the number of active participants separated as a result, and the total number of active participants. These determinations are not always so easy to make, particularly

[4] 71 Fed. Reg. 34819, 34822 (to be codified at 29 CFR § 4062.8(a)).

[5] *Id.*

[6] *Id.* at 34820.

[7] *Id.* at 34822 (to be codified at 29 CFR § 4062.8(b)).

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given the broad array of interpretive issues under ERISA Section 4062(e) that the final rule does not address.

The single sentence that makes up the entirety of ERISA Section 4062(e) raises several questions. For example:

- What is a ''facility in any location'' where there are two or more geographically proximate buildings at which the same or related ''operations'' are conducted?
- What if the buildings are far removed from each other geographically but the work performed in them makes up an integrated set of ''operations?''
- Can there be two ''facilities'' within a single building?
- Is the cessation of one set of ''operations'' enough to trigger Section 4062(e) liability where other ''operations'' continue at the same facility? If so, what constitutes ''operations'' that are sufficiently distinct from other ''operations'' at the same facility?
- Must the ''cessation'' of the operations (or of all operations) at the facility be a complete cessation, without regard to the completion of any work in progress?
- What is the date of a ''cessation'' when it occurs in two or three stages, or gradually over an extended period of time?
- Can a cessation of operations at Facility A ''result'' in the separation of an employee at Facility B (*e.g.*, a warehouse stocking parts for the operations at Facility A)?
- What about employees who separate for reasons not clearly tied to the cessation (including normal attrition)? At what point is an employee to be treated as having been ''separated'' in the context of layoffs, recall rights, etc.?
- Under what circumstances, if any, might an asset sale constitute a Section 4062(e) event? (Several early PBGC opinion letters concluded that there was no Section 4062(e) event in the context of the particular asset sales presented for consideration.[8])

These interpretive issues could make it difficult to determine whether there is liability and, if so, how much it is under the regulatory liability formula.

Of course, there are many situations in which these issues do not arise and for which the regulatory liability formula should be easy to apply. For example, where a separate and distinct facility undergoes a complete shutdown on a single date, the application of the formula could significantly expedite the determination of the resulting liability.

Several commenters asked for additional guidance on a number of interpretive issues (such as those noted above) relating to Section 4062(e) that were not addressed in the proposed rule. Although PBGC ''agree[d] that additional guidance in this area is warranted,'' it noted that the final rule ''is narrow in scope and is intended to address one overarching aspect of ERISA Sec. 4062(e)—the formula for calculating employer liability,'' and determined that the interpretive issues raised by the commenters ''remain outside of the scope of this rulemaking.''[9] Fortunately, PBGC also stated that it ''plans to issue additional guidance as appropriate, recognizing that such guidance would provide valuable assistance to plan administrators, employers, and participants, especially in determining whether and when a section 4062(e) event has occurred,'' and that it would take the commenters' concerns into account when it develops this guidance.[10] Unfortunately, what this means for practitioners is that, pending further guidance, these issues ''will continue to be resolved on a case-by-case basis.''[11]

Small Plan Exemption. One commenter asked PBGC to exempt small plans (generally, those with fewer than 500 participants) from liability under ERISA Section 4062(e). PBGC chose not to add such an exemption to the final rule because of its view that the request was beyond the scope of this narrow rulemaking. However, PBGC stated that it ''will consider this request as it formulates additional guidance in this area.''[12]

Cap on Liability. PBGC described the regulatory liability formula as ''simple,'' ''practicable,'' ''equitable,'' and ''transparent,'' noting that it ''will allow plan sponsors who experience a section 4062(e) event (or believe they may experience a section 4062(e) event) to readily determine their liability (or expected liability).''[13] In many cases, the formula will work quite well. However, commenters expressed concern that the simplicity of the ''headcount'' approach could result in an ''unreasonable'' outcome, noting that the liabilities of the separated participants might represent a small percentage of all liabilities, yet the Section 4062(e) liability imposed under the regulatory liability formula could be substantially larger. PBGC noted, by way of example, a situation in which the facility that closed had recently been opened with all newly hired employees, where the benefit liabilities associated with the separated employees could be quite small. Yet if those separated employees represented 25 percent of the plan's active participants, the liability under the regulatory formula would be 25 percent of the plan's underfunding. The commenters recommended that the liability be limited to a fraction of the unfunded liability based upon benefit liabilities attributable to participants who separated as a result of the cessation of operations.

PBGC declined to place such a cap on the liability, noting that it had considered but rejected a liabilities-based approach primarily because it found that employers had great difficulty separating liabilities by employee group and that, therefore, ''this sort of liabilities-based approach would not provide a simple, predictable formula for determining section 4062(e) liability.''[14] PBGC also stated that ''the liabilities-based approach would not necessarily provide a result more in line with statutory intent than would the headcount approach prescribed in this rule.''[15] In this connection, PBGC noted that even the statutory method (tied to contribution history) does not represent an exact calculation of the unfunded benefit liabilities for all of the employer's employees or former employees that participated in the plan. Ultimately, PBGC concluded that ''[t]he headcount method in this rule provides a simple, practicable, and equitable method for determining employer liability under section 4062(e) [, and] . . . attributes to the em-

[8] See, *e.g.*, PBGC Opinion Letters 76-52, 77-147, 78-29, and 82-29.

[9] 71 Fed. Reg. at 34820.

[10] *Id.*

[11] *Id.*

[12] *Id.*

[13] *Id.*

[14] *Id.*

[15] *Id.*

ployer responsibility for an appropriate amount of plan underfunding upon the cessation of operations in much the same way that ERISA section 4063 attributes to a substantial employer responsibility for a portion of plan underfunding upon withdrawal.''[16]

Effective Date and Applicability of New Regulatory Liability Formula

The final rule and, thus, the new regulatory liability formula, applies to Section 4062(e) events occurring on or after July 17, 2006. PBGC stated that the final rule would have ''little or no effect on the imposition or amount of liability,'' noting that the liability is statutorily imposed and that the amount of liability has generally been determined on a case-by-case basis using the same regulatory liability formula as in the final rule.[17] Of course, what is changing is in a sense very significant, in that the final rule creates a legal requirement to use the PBGC's liability formula, whereas in the past PBGC needed the consent of the employer to ensure its use. Significantly, the final rule is not retroactive, so that the new legal requirement does not apply to Section 4062(e) events occurring before July 17, 2006.

Notice to PBGC of Section 4062(e) Event

Although the final rule did not specifically address the time, form, or manner of notice to the PBGC that a Section 4062(e) event has occurred (other than to note that the Section 4062(e) notice requirement is separate from the requirement to notify PBGC of any related ''active participant reduction'' reportable event[18]), practitioners should be aware of the PBGC's informal guidance on such notice. That guidance provides that notice of a Section 4062(e) event is required (under ERISA Section 4063(a)) within 60 days after the event; must contain notification of the cessation of operations within the meaning of ERISA Section 4062(e) and a request for a liability determination; has no prescribed format; must be filed with the PBGC's Department of Insurance Supervision and Compliance (''DISC''); and may be mailed to DISC at 1200 K Street, NW, Washington, DC 20005-4026, faxed to DISC at (202) 842-2643, or e-mailed to DISC at 4063.report@pbgc.gov.[19]

Conclusion

Practitioners would be well-advised to be familiar with ERISA Section 4062(e) and the issues it raises. PBGC's final rule appears to be aimed at making this provision a more effective tool for limiting its exposure. Given PBGC's current financial condition, it is reasonable to expect PBGC to use this tool more frequently and aggressively in the future.

[16] *Id.* at 34821.
[17] *Id.*
[18] *Id.* at 34819, n.1.
[19] See Q&A 21-22 of the PBGC's 2006 Enrolled Actuaries Meeting Blue Book, available at http://pbgc.gov/docs/2006bluebook.pdf.

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