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HEALTHCARE EMPLOYERS WITH UNAFFORDABLE PENSION PLANS: A NON-BANKRUPTCY SOLUTION

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Introduction

During these financially challenging times, for-profit and not-for-profit hospitals, nursing homes and other employers providing healthcare services are finding that the skyrocketing costs of funding their defined benefit pension plans are increasing operating pressures to the point of threatening their viability and ultimate survival. This article addresses this problem in the context of the other financial and economic challenges facing these vitally important healthcare providers, and identifies an under-utilized legal solution that could mitigate or even eliminate a major issue that for many of them is becoming an existential financial threat.

Background

In 1974, Congress enacted the Employee Retirement Income Security Act ("ERISA").[1] One of the principal purposes of ERISA is to protect the pensions of the millions of Americans participating in privately maintained defined benefit pension plans. Title IV of ERISA[2] established the Pension Benefit Guaranty Corporation (the "PBGC"), a federal corporation chaired by the Secretary of Labor that generally is patterned after the Federal Deposit Insurance Corporation. Among its various responsibilities, the PBGC administers a single-employer insurance fund that provides retirement payments to participants and beneficiaries up to ERISA guaranteed limits in the event that an employer that sponsors an insured defined benefit pension plan goes out of business or otherwise becomes unable to continue to maintain its underfunded pension plan.[3]

When the PBGC provides insurance coverage for underfunded single-employer pension plans, the plan is "terminated." In virtually all of these cases, the PBGC becomes the trustee of the pension plan, taking over the plan's assets and assuming its liabilities, up to ERISA guaranteed limits, currently $54,000 per year for those who retire at age 65 with an annuity that does not include survivor benefits.[4] The ERISA guaranty most often covers all benefits earned by a participant under a terminated plan. On occasion, the various statutory guarantee limits can result in benefit cutbacks, which can be significant.

Over the past three decades, a number of troubled domestic industries, such as airlines, textiles and steel, have imposed significant burdens on the single-employer insurance fund, which is not funded by taxpayer dollars. The fund's assets are obtained from annual insurance premiums, the assets of pension plans that have been terminated and trusteed by the PBGC, the PBGC's recoveries on its claims relating to pension plan terminations, a special plan termination premium, and returns on the investments of the fund's assets. In addition to the costs of operating the PBGC, the fund's expenses principally consist of benefit payments to participants and beneficiaries in PBGC-trusteed pension plans. The PBGC operates as a regulatory agency and an insurer. The insurance fund itself essentially operates as an extremely large pension plan, covering well over a million participants and beneficiaries of underfunded terminated pension plans.

At the end of the PBGC's 2010 fiscal year, the single-employer insurance fund was underfunded on a long term

1 29 U.S.C. § 1001 *et seq.*; Pub. L. 93-406, 88 Stat. 829 (enacted September 2, 1974).

2 29 U.S.C § 1301 *et seq*.

3 ERISA provides insurance for both single-employer and multiemployer pension plans. Multiemployer pension plans are collectively bargained pension plans where unrelated employers that usually are in the same industry contribute to a pension plan pursuant to at least one collective bargaining agreement. The multiemployer system operates under an ERISA Title IV insurance fund that is separate and apart from the single-employer fund. The single-employer insurance fund is the much larger of the funds. The PBGC's regulatory and enforcement authority is exercised more frequently under the single-employer pension insurance program, which generally covers defined benefit pension plans maintained by individual companies or a group of commonly owned companies. This article focuses only on PBGC covered single-employer defined benefit pension plans.

4 29 U.S.C. § 1322(b)(3); 29 CFR § 4022.22; PBGC Press Release No. 11-04 ("PBGC Announces Maximum Insurance Benefit for 2011"), available at www.pbgc.gov/news/press/releases/pr11-04.html. In certain circumstances, the PBGC will pay participants at least a portion of their non-guaranteed benefits, with the amount depending on plan asset levels and the values of the PBGC's recoveries on its underfunding claims against employers. 29 U.S.C. §§ 1322(c), 1344. See discussion *infra*.

basis by approximately $21.6 billion, with pension benefit liabilities, measured as the present value of future benefit payments, of approximately $90 billion.[5] However, the insurance fund has sufficient assets, almost $70 billion at fiscal 2010 year end, to provide benefit payments to participants and beneficiaries in PBGC-trusteed pension plans for many years.[6]

Titles I and IV of ERISA and certain provisions of the Internal Revenue Code (the "IRC") arm the PBGC with the authority to assert various claims and to take various actions, enumerated in detail *infra*, to protect the solvency and integrity of the pension insurance program.[7] The PBGC uses its statutory tools and becomes involved in many areas of corporate existence, such as when employers fall behind in their periodic pension funding obligations, bankruptcies, mergers, acquisitions, restructurings, spinoffs, asset sales, and even facility downsizings and closings.

While well intended and providing an important societal safety net, the ERISA and Internal Revenue Service ("IRS") pension rules have imposed significant costs and administrative burdens on employers that sponsor guaranteed defined benefit pension plans. ERISA and the IRC require sponsoring employers and the members of their "controlled groups"[8] to meet what often are unexpectedly burdensome statutory funding requirements, and impose on these entities investment, interest rate, longevity, and other actuarial risks associated with ensuring that pension plan assets will be adequate to pay promised benefits.[9]

Although the popularity of the defined benefit system has been in steady decline since 1985,[10] with a marked shift towards defined contribution plans,[11] many healthcare providers, both for-profit and not-for-profit, continue to sponsor insured defined benefit pension plans. Often, defined benefit pension plan sponsorship is a matter of long standing tradition, perhaps reflecting what is a historically more paternalistic employer-employee relationship, or is required by the provisions of collective bargaining agreements that cannot readily be shed. Eliminating the defined benefit retirement vehicle also can result in significant employee relations issues.

As set forth *infra*, in these challenging times, the continued sponsorship of defined benefit pension plans often results in significant financial burdens that can complicate and even jeopardize the viability of healthcare providers. However, there are solutions available under the law that may overcome what for some employers may be the key impediment to survival.

Healthcare Providers and Defined Benefit Pension Plans

There are a number of factors that have diminished cash reserves and decreased operational flexibility in the healthcare industry, including:

1. Annual pension contribution requirements that have, for many employers, more than doubled due to a combination of:
    a. changes in the law, enacted in the Pension Protection Act of 2006 (the "PPA"),[12] that have greatly accelerated pension funding obligations for many pension plans, generally accelerating amortization of funding costs from as long as 30 years to seven years;
    b. declines and uncertainties with respect to equity values due to the recession and more recent turbulence in the capital markets; although equity values have recovered significantly from the 2007-2009 period, the declines nevertheless had the effect of decreasing the value of pension plan assets that were available to pay benefits and increasing pension funding obligations; and
    c. the long term low interest rate environment, projected to continue for the foreseeable future, which, while benefiting borrowers, increases the value of pension plan benefit liabilities and therefore increases pension funding obligations;
2. decreased patient volumes and shorter hospital, rehabilitation and temporary nursing home stays, along with increased use of home based or outpatient care, all of which adversely affect revenues;

[5] 2010 PBGC Annual Report, Pension Benefit Guaranty Corporation, www.pbgc.gov , at 19.

[6] *Id.*

[7] 29 U.S.C. §§ 1082, 1303(e), 1306(a)(7), 1362, 1368; 26 U.S.C. § 430.

[8] *See* discussion *infra* concerning what controlled groups are and what the legal consequences of being a member of a controlled group are with respect to defined benefit pension plans.

[9] 26 U.S.C. § 430; 29 U.S.C. § 1082.

[10] There were 112,200 single-employer plans insured in 1985 and 26,100 in 2010. PBGC Pension Insurance Data Book 2008 at 4; 2010 PBGC Annual Report at 2, both available at www.pbgc.gov.

[11] Defined contribution plans (*see*, *e.g.*, 26 U.S.C. §§ 401(k) and 403(b)) differ fundamentally from defined benefit plans. Defined benefit plans typically provide benefits based on formulas involving average or final compensation and/or years of service. Underfunding of defined benefit plans, which can be caused by a variety of factors, remains an obligation of the sponsor of the pension plan and its controlled group members even after required periodic minimum funding contributions have been made. Defined contribution plans provide benefits to employees from individual employee accounts based on contributed funds from the employer and/or the employee and returns on investments. Unlike a defined benefit plan, after the employer provides required funding in a defined contribution plan, investment, interest rate, longevity and other risks then fall on the employee. Over the past decade or more, because of the shifting of risks and, in some cases, reduced costs, defined contribution plans, which originally were designed to supplement more traditional retirement programs, generally have become more attractive to employers as a principal retirement vehicle. Because of portability features, defined contribution plans also have become more attractive to employees, who now tend to change employers with far greater frequency than during earlier periods.

[12] Pub. L. 109-280, 120 Stat. 780 (August 17, 2006).

3. decreased availability of employer based health plan coverage and lesser amounts of coverage even where employer based health insurance is available, factors that may be impacted by the healthcare reform legislation,[13] which is expected to increase the availability of health insurance (although as a result of pending constitutional challenges, certain features of healthcare reform may be in doubt);
4. large and chronic increases in unemployment, hovering above nine percent and projected to continue at extraordinarily high levels for the foreseeable future, along with a significant segment of the population that no longer is seeking employment and has left the nation's potential workforce, with attendant increased cases of foregone, uninsured, under compensated or uncompensated medical services, also adversely affecting revenues;
5. the aging of the population and attendant increased healthcare needs and increased reliance by healthcare institutions and other providers on Medicare and Medicaid reimbursements, coupled with decreased third party compensation, particularly from Medicare and Medicaid, due to declining federal and state government revenues, major federal and state government budget deficits, the likelihood of significant cutbacks in government spending, and tighter cost controls and additional cost control initiatives, also adversely affecting revenues;
6. reduced charitable giving due to the effects of declines in equity values and the fallout from the Bernard Madoff and other financial scandals;[14]
7. the general effects of continual modernization and inflationary costs in the healthcare industry, which have been far higher than those experienced by the economy as a whole; and
8. as a result of all of the above, diminished cash reserves and significantly constrained operating flexibility.

The effects of these multiple and largely inter-connected problems have converged at a most inopportune time, when cash starved for-profit and not-for-profit healthcare providers can least afford significantly increased pension costs.

Over the past several years these problems have been the subject of a considerable amount of attention and comment in the media and in the trade press. Of particular note is an article published on July 6, 2009 by *Modern Healthcare*, an industry publication, concerning problems arising from hospital pension plan underfunding.[15]

The article reports on an unpublished study conducted by the PBGC staff (the "PBGC Study").[16] The PBGC Study addresses systemic problems of the federal pension insurance system, itself under considerable long term financial stress[17] posed by significantly underfunded pension plans sponsored by many financially distressed and cash strapped not-for-profit hospitals. According to the PBGC Study, many not-for-profit hospitals, which populate a community-based fragmented industry, are operating on thin or negative margins and are facing increased revenue pressures from Medicare and Medicaid rate cuts and reduced reimbursements from private insurers, while simultaneously experiencing numerous expense increases, such as those relating to workforce retention, employee benefits, malpractice insurance, pharmaceuticals, clinical technology, facility and information systems upkeep and modernization, more patients with acute conditions, and uninsured and charity cases.[18] The PBGC Study found that these changes have exacerbated many hospitals' already precarious finances.[19]

On April 7, 2010, Standard & Poor's, an independent provider of credit ratings, issued a report available to its subscribers (the "S&P Report") concerning pension funding issues that were adversely affecting the financial profiles of not-for-profit hospitals and health systems.[20] The S&P Report noted that median pension plan funding levels decreased by approximately 22 percent since 2007, with funding levels, defined as the amount of plan assets as a percentage of projected benefit obligations, of 68.6 percent in 2009, compared to 82.9 percent in 2008 and 90.4 percent in 2007.[21]

The S&P Report concluded that decreases in pension funding levels, when combined with the impact of the acceleration of defined benefit pension funding obligations from the PPA, likely will translate into a steep increase in pension costs for many institutions over the next several years, putting additional strain on financially distressed not-for-profit healthcare institutions already "coping with significant challenges such as softer patient volumes and cash reserves."[22] The S&P Report also concluded that since pension "contribution requirements tend to lag asset changes," for many institutions "sharp increases in pension

13 Patient Protection and Affordable Care Act, Pub. L. 111–148, 124 Stat. 119 (March 23, 2010); Health Care Education and Reconciliation Act of 2010, Pub. L. 111-152, 124 Stat. 1029 (March 30, 2010).

14 *See*, *e.g.*, Aleccia, JoNel, "Madoff Aftermath Cuts Funds for the Vulnerable (Foundation Losses Jeopardize Health Care for Those Who Never Invested)" (www.msnbc.com, June 29, 2009); "Recession Curbs Giving to Hospital Foundations" (Modern Healthcare, January 5, 2009).

15 Galloro, Vince, "Pension Tension: Hospital Plans Pose Unique Challenges for Pension Guaranty Agency" (Modern Healthcare, July 6, 2009).

16 "U.S. Healthcare Industry: Hospitals & Defined Benefit Pension Plans" (March 18, 2008) (the "PBGC Study"). The PBGC Study was obtained pursuant to a request under the Freedom of Information Act, 5 U.S.C. § 552, and is available from the author upon request.

17 *See* discussion *supra*.

18 PBGC Study at 3, 5, 12.

19 *Id*.

20 "Pension Funding Woes Escalate for U.S. Not-For-Profit Hospitals and Health Systems" (Standard & Poor's, April 7, 2010).

21 *Id*. at 1.

22 *Id*. at 2.

contributions [are expected] to kick in [during 2010] and, in many cases, in 2011."[23] For hospitals and healthcare systems already "grappling with compressed operating margins" and "liquidity challenges," the additional expenses will further strain their budgets, income statements and balance sheets.[24]

The problems caused by the factors cited above are not isolated to the not-for-profit healthcare sector, applying to for-profit healthcare providers as well. And, although pension funding relief became law in June 2010,[25] the effect of this legislation ultimately is to increase pension funding obligations by back loading principal payments, which also serves to increase interest charges. The same is true for minimum funding waivers that may be obtained from the IRS in certain cases where temporary substantial business hardship is demonstrated and other required legal criteria are met.[26] Given the long term nature of the financial challenges facing healthcare providers, for many, funding relief and funding waivers may only delay the problem, since the amount of required contributions and added interest charges, pushed back to later years, would continue to be unaffordable, even if the interest costs associated with the deferral are less than they would be based on other sources of financing.

Often employers that are cash strapped have little or no choice but to resort to insolvency proceedings for protection and respite. There is, however, a sensible and viable non-bankruptcy solution to this problem that may be available to financially ailing healthcare providers, both for-profit and not-for-profit, that have unaffordable guaranteed pension plans. An underutilized provision of Title IV of ERISA's distress termination structure, often referred to as the business continuation test,[27] could provide an employer with a path that would enable it to continue in business unburdened by unaffordable pension obligations, without the need to resort to bankruptcy proceedings.

Although terminating a pension plan may be painful for both an employer's management and current and former employees, if it comes down to a choice between continuation of the pension plan and the survival of the employer, under the ERISA Title IV business continuation test, the employer's survival, along with the preservation of the jobs provided by the employer, must come first.

[23] *Id*. at 12.
[24] *Id*. at 2, 5.
[25] The Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2010, Pub. L. 111-192, 124 Stat. 1280 (June 25, 2010). This legislation offered employers the option to choose 2&7 funding relief (two years of interest only pension contributions, followed by seven year amortization of principal and interest funding) or 15 year amortization of principal and interest funding.
[26] 26 U.S.C. § 412(d).
[27] 29 U.S.C. § 1341(c)(2)(B)(iii)(I).

The Legal Framework of Title IV of ERISA: Pension Plan Termination Options

A single-employer defined benefit pension plan covered by the termination insurance program administered by the PBGC may be terminated only in accordance with Title IV of ERISA.[28] There are only two ways to initiate termination of a pension plan voluntarily: a standard termination[29] and a distress termination.[30]

Standard terminations are accomplished through 1) the purchase of annuities from life insurance companies that will pay a participant's or beneficiary's full benefit earned under the plan; 2) where permitted by the plan, the payment of lump sums;[31] or 3) a combination of these two methods of satisfying all of the plan's benefit liabilities, irrespective of PBGC insured limits. Because a standard termination requires that a pension plan be fully funded (*i.e.*, it must have sufficient assets to cover all of its benefit liabilities[32]), this way of terminating a pension plan is expensive, often prohibitively so, and is out of reach for many of the employers in the healthcare field. Although lump sum costs have been reduced as a result of PPA changes,[33] on a present value basis they are still generally roughly comparable to ongoing funding costs, and annuities can be expensive, as the insurance company providers tend to rely on conservative assumptions and build in a profit component in their annuity pricing. Where there is a substantially underfunded plan, the amount needed to fund up the plan to accomplish a standard termination can be even more unaffordable to an employer than continuing to maintain the plan. In such a case, assuming that the employer desires to continue in business, a distress termination may become the only viable legal option for the employer.

To qualify for a distress termination, the sponsor of the pension plan and each member of its controlled group must meet one of the four financial distress tests contained in Title IV of ERISA.[34] The controlled group members do not need to meet the same distress test. The distress termination and controlled group rules, which can be complicated in their application, apply to both for-profit and not-for-profit entities.

The application of the controlled group rules, which involve the provisions of both ERISA and the IRC,[35] can be

[28] 29 U.S.C. § 1341(a)(1).
[29] 29 U.S.C. § 1341(b).
[30] 29 U.S.C. § 1341(c). In appropriate circumstances, the PBGC may seek the termination of a pension plan on its own initiative. 29 U.S.C. § 1342. This procedure often is referred to as an involuntary termination
[31] A lump sum generally is the payment of a benefit in a single installment representing the present cash value of a participant's benefit.
[32] 29 U.S.C. § 1341(b)(1)(D).
[33] 26 U.S.C. § 417(e)(3); 29 U.S.C. § 1055(g).
[34] 29 U.S.C. § 1341(c)(2)(B).
[35] 26 U.S.C. §§ 414, 430, 1563 and accompanying Treasury Regulations; 29 U.S.C. §§ 1082, 1301(a)(14), 1306(a)(7), 1341(c), 1362, 1368 and accompanying PBGC regulations.

complex.[36] Generally, with respect to for-profit companies, a controlled group includes trades or businesses related to each other through 80 percent or more ownership by a parent company or companies (this is known as a parent-subsidiary controlled group),[37] or by the same five or fewer individuals, estates, and/or trusts (this is known as a brother-sister controlled group).[38] There also may be combined controlled groups, which have elements of both of the parent-subsidiary and brother-sister controlled group structures.[39]

Because of the unique structures of not-for-profit entities, the IRS has issued regulations defining what constitutes a controlled group in this setting.[40] These regulations focus not on ownership, but rather, on interconnected boards of directors or trustees. Generally, a controlled group exists between a tax-exempt organization and any other organization where 80 percent or more of the directors or trustees of one organization either are representatives of or are directly or indirectly controlled by the other organization.

Of the four ERISA Title IV distress tests, the first two (the liquidation and reorganization tests) apply only to controlled group members who are in bankruptcy or insolvency proceedings under federal, state or local law. The first distress test applies to liquidations, in which the entity will not emerge from the proceeding.[41] The second distress test applies to reorganizations.[42] Under the reorganization test, the bankruptcy or other appropriate court is asked to make a judicial finding that, unless the pension plan terminates, the insolvent plan sponsor or controlled group member will be unable to pay all of its debts under a plan of reorganization and will be unable to continue in business outside of the reorganization process. Based on such a finding, the court then is asked to approve the termination of the pension plan.

An ongoing employer seeking to terminate its underfunded defined benefit pension plan thus may attempt to do so as part of a Chapter 11 bankruptcy reorganization under the second distress test. However, bankruptcy often is expensive, time consuming, distracting to management and employees, inefficient, disruptive and harmful to the ongoing business of the reorganizing entity, damaging to the customer, client or patient base, damaging to vendor and other significant business relationships, and even could result in a loss of control of the reorganizing entity. Particularly in the healthcare field, where patient confidence is critical, anecdotal evidence suggests that there are compelling reasons to avoid bankruptcy if possible.[43]

The third and fourth distress tests apply to ongoing financially distressed employers that are not in bankruptcy or insolvency proceedings. The focus of this article is on the third distress test, the business continuation test.[44]

The Business Continuation Test

For an employer whose non-pension debt is manageable or may be successfully renegotiated outside of bankruptcy, the third distress test may provide an avenue of relief from unaffordable pension costs without the burdens and costs and other disadvantages of filing for bankruptcy.[45] Unlike the second distress test, the determination of distress under the business continuation test initially is made by the PBGC. The focus is not on the need to get out of bankruptcy, which is what the second distress test is directed towards, but rather, on staying out of bankruptcy in the first place.

A controlled group member qualifies for distress if it demonstrates "to the satisfaction of the [PBGC] that, unless a distress termination occurs, such person will be unable to pay such person's debts when due and will be unable to continue in business."[46] The test is viewed by the PBGC as requiring a "but for" demonstration: that the pension plan's funding obligation is the determining factor as to whether the employer can survive as an ongoing business. If the business entity and its controlled group cannot survive even without the pension plan's funding obligations, then the business continuation option will not be available. In such a case, it is likely that the options of a bankruptcy reorganization or liquidation will need to be considered.[47]

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[36] The intricacies of the controlled group concepts and rules are beyond the scope of this article.

[37] 26 U.S.C. §§ 414(a), 414(b), 1563(a)(1).

[38] 26 U.S.C. §§ 414(a), 414(b), 1563(a)(2).

[39] 26 U.S.C. §§ 414(a), 414(b), 1563(a)(3).

[40] 26 C.F.R. § 1.414(c)-5.

[41] 29 U.S.C. § 1341(c)(2)(B)(i).

[42] 29 U.S.C. § 1341(c)(2)(B)(ii).

[43] Nor, in many cases, will a Chapter 11 filing restore a not-for-profit hospital to financial health. The PBGC Study notes that there are few bankruptcy filings for not-for-profit hospitals "because of different drivers in the non-profit environment," as there is "little to be gained from [the] ability to discharge debts." PBGC Study at 7.

[44] 29 U.S.C. § 1341(c)(2)(B)(iii)(I). The fourth distress test, 29 U.S.C. § 1341(c)(2)(B)(iii)(II) (unreasonably burdensome pension costs that arise "solely" as a result of a decline in the workforce covered by the employer's pension plan or plans) is rarely used, but should be considered in conjunction with the third distress test where there is an unaffordable pension plan and there has been a significant drop in the covered workforce.

[45] Under ERISA and PBGC regulations, a pension plan may not terminate in a standard or distress termination if a union challenges the termination as violating the terms of an existing collective bargaining agreement. 29 U.S.C. § 1341(a)(3); 29 C.F.R. § 4041.7. In such a case, the pension plan will remain ongoing pending the resolution of the union challenge in the appropriate labor relations forum, and ultimately may have to remain ongoing throughout the term of the collective bargaining agreement. By contrast, in bankruptcy there are special procedures that, depending on the circumstances, may allow an employer to reject a collective bargaining agreement or certain of its provisions. 11 U.S.C. § 1113. If the bankruptcy court enters an order that rejects the collective bargaining agreement or its terms concerning the obligation to maintain the pension plan, a distress termination may proceed. PBGC initiated terminations pursuant to 29 U.S.C. § 1342 may proceed irrespective of whether plan maintenance is required by the provisions of a collective bargaining agreement. 29 U.S.C. § 1341(a)(3).

[46] 29 U.S.C. § 1341(c)(2)(B)(iii).

[47] The business continuation test has not been used as often as the bankruptcy/insolvency distress tests because the factors that cause employers to seek bankruptcy protection often are more fundamental to their business models or financial situations, going well beyond just the financial burdens of the pension plan. In cases where there are substantial business and financial problems beyond the undue burdens of pension plan funding that necessitate a bankruptcy reorganization, the "but for" pension plan affordability element of the business continuation test may not be met.

Since the statute requires that the distress application demonstrate to the PBGC's satisfaction that the business continuation test is met, the burden of establishing distress falls on the applicant.[48] In evaluating an application under this test, the PBGC can be expected to make a searching inquiry into the plan sponsor and the members of the plan sponsor's controlled group's financial history, status and prospects.[49] In its distress termination filing instructions,[50] the PBGC requires the submission of substantial financial and actuarial information, including:

- annual financial statements (audited financial statements if available) and federal tax returns for the five most recent fiscal years, and interim financial statements for the current fiscal year;
- projected revenues, expenses and cash flow, for at least the next five fiscal years, that demonstrate a well thought out and viable business plan going forward without the pension plan's funding requirements;
- pension cost information, including pension funding projections for the next five plan years assuming an ongoing plan, which, in conjunction with the business plan and financial projections, demonstrate that the pension plan is unaffordable;
- projections showing the cost of the pension plan's termination based on payment of projected affordable termination liabilities, which, in conjunction with the business plan and financial projections, demonstrate that the controlled group member can continue in business following the pension plan termination; and
- a statement for each controlled group member that identifies the distress test or tests that are expected to be met, along with detailed supporting descriptions as to why the test is met.[51]

This submission often is the most critical part of the application.[52] To maximize the prospects of success, the submission should amount to an integrated, detailed and comprehensive analysis of the financial and actuarial information that supports the application, both historical and projected, in light of the legal requirements for meeting the business continuation test. To support the applicant's business plan's revenue projections, it is useful to provide information concerning the industry in which the entity operates, and it also may be useful to include relevant information concerning the international, national and local economies and markets in which the entity operates.

As part of its analysis, the PBGC staff will require a demonstration that all reasonable cost-cutting and other austerity measures have been implemented and that termination of the pension plan is the last resort to prevent the business's demise or descent into insolvency. Relevant information may include showings that:

- loans have been renegotiated to contain more favorable repayment terms to the extent possible;
- contracts with employees and suppliers have been renegotiated where appropriate and feasible;
- capital expenditures have been cut or postponed to the extent prudent;
- executive compensation has been reduced and perquisites have been curtailed or eliminated to the extent feasible, taking into account the need to offer competitive compensation packages;
- operating inefficiencies have been identified and corrected where possible;
- non-performing business units have been or are being modified, sold or closed, and non-core assets have been or are being divested;
- the employer has been and will be unable to obtain financing or capital investment absent termination of the pension plan;
- assets that are available to fund the pension plan, including the proceeds from borrowing or sales of non-core assets, have been so applied;
- consideration has been given to the possibility and feasibility of implementing a pension plan participation or benefit accrual freeze or both, applying for one or more minimum funding waivers from the IRS, opting for funding relief provided by recent legislation, or making appropriate changes in the pension plan's actuarial assumptions in a way that would favorably impact the timing of funding requirements; and
- the projected cost of providing alternative retirement arrangements for employees, such as a new or enhanced IRC Section 401(k) or Section 403(b) plan, is reasonable and affordable.

In order to maximize the prospects for success, a business continuation test application should include a detailed and comprehensive presentation and analysis of the foregoing information and attendant financial, actuarial and legal issues. This typically requires the coordinated input of expert professionals, including pension counsel, actuaries, accountants and, depending on the size and complexity of the case, financial analysts.

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[48] 29 U.S.C. § 1341(c)(2)(B)(iii).

[49] The first and second distress tests, involving insolvency proceedings, require judicial consideration and approval. The business continuation test (the third distress test) requires only administrative approval by the PBGC. Although anecdotal, the author's experience indicates that the absence of a judicial distress finding may result in more stringent scrutiny of a distress termination application by the PBGC staff.

[50] www.pbgc.gov/Documents/600_instructions.pdf.

[51] *Id.*

[52] *Id.* This information is required by Item 9c of PBGC Form 600, which is the filing mechanism for distress terminations.

The business plan and the other information that is submitted will be evaluated by the PBGC's financial analysts and actuaries, who typically have significant qualifications and substantial experience in this area, and the PBGC legal staff, who are well versed in ERISA and PBGC's regulatory distress termination requirements. The information that is submitted must be comprehensive and persuasive, and far more than just a last minute hastily thrown together desperate "Hail Mary" pass to transfer the pension liability over to the PBGC.

The distress termination process can be expected to generate follow-up inquiries and requests for additional information from the PBGC's staff, and, depending on the issues raised, telephone conferences with the staff, where information that has been provided is delved into or legal or factual issues are discussed. Where necessary, meetings with the PBGC's staff take place.

Pension Plan Termination and Related Liabilities

If distress is found and the pension plan terminates, in virtually every case the PBGC will take over control of the pension plan's assets and assume and pay its benefit liabilities, up to ERISA Title IV insured limits.[53] The benefits of participants and beneficiaries that exceed Title IV limits are reduced to those limits, subject to administrative appeal rights and judicial review.[54] After a transition period, the PBGC will begin paying monthly benefits and will perform administrative and customer service functions for the pension plan's participants and beneficiaries, including determining the proper amount of benefits and placing participants and beneficiaries into pay status.

Under Title IV of ERISA, certain liabilities must be dealt with upon termination of the pension plan. In particular, the sponsor and each member of its controlled group are jointly and severally liable for:

- the amount of the pension plan's unfunded benefit liabilities,[55] *i.e.*, the plan's total underfunding calculated in accordance with PBGC regulations;[56]
- unpaid minimum funding contributions attributable to the period up to the pension plan's termination date;[57]
- shortfall amortization and waiver charges;[58]
- unpaid annual PBGC premiums and related penalty and interest charges, if any;[59] and
- a sizeable termination premium, in the nature of an exit fee, of $1,250 per participant per year, for three years following the pension plan's termination (*i.e.*, a total of $3,750 for each participant, whether active, terminated vested, in pay status, or deceased with a beneficiary entitled to benefits).[60]

Since it is axiomatic that the sponsor of the pension plan and the members of its controlled group in an approved distress termination application cannot afford to continue to fund the pension plan, they likewise will not be able to afford to pay the foregoing termination and other liabilities, some of which are accelerated obligations, in full. These liabilities most often will significantly exceed the cost to maintain the pension plan.

Fortunately, the PBGC has broad authority to settle employer liabilities in connection with pension plan terminations,[61] and is unlikely to approve a distress termination based on the need to ensure that an employer can continue in business, and then insist on a settlement structure that would result in the employer's demise. Once the pension plan terminates, the employer and the PBGC typically negotiate a claims settlement that the employer can afford to pay and that enables the employer to continue in business, while continuing to provide a livelihood for its employees, thus fulfilling the purpose of the business continuation test.

The Need for Prompt Action

It is important for an employer to assess the scenario contemplated by this article promptly and carefully. Delay or avoidance invariably is not beneficial, especially if required periodic pension plan contributions have not been made. Doing so likely will exacerbate matters considerably and could prove to be disastrous. As long as the pension plan sponsorship continues, costs and complications will mount:

- minimum funding contributions required by the terms of the pension plan, ERISA, and the IRC, already unaffordable, will continue to accrue, with interest;
- if required minimum funding contributions are not made, liens for the benefit of the pension plan will arise against the property and rights to property of all of the members of the controlled group once the total

[53] 29 U.S.C. §§ 1341(c)(3)(B)(iii), 1342.

[54] 29 U.S.C. §§ 1301(f), 1322; 29 C.F.R. § 4003.

[55] 29 U.S.C. § 1362(b)(1).

[56] This liability arises upon termination of the pension plan, is designed to replicate annuity pricing by private sector insurance companies, thus is expensive, and most often will result in sticker shock for an employer accustomed to seeing much lower underfunding numbers determined on an ongoing funding or financial statement basis.

[57] 26 U.S.C. § 430; 29 U.S.C. § 1082. The liability to the pension plan for unpaid required periodic contributions exists independent of the pension plan termination, and becomes a claim enforceable by the PBGC on behalf of the pension plan once the total of unpaid contributions, including interest, exceeds $1 million. Upon termination and PBGC trusteeship of the pension plan, all claims for unpaid required contributions become the PBGC's claims in its capacity as the plan's trustee.

[58] 29 U.S.C. § 1362(c).

[59] 29 U.S.C. §§ 1306, 1307. Unpaid PBGC annual premiums are liabilities that are not dependent on termination of the pension plan.

[60] 29 U.S.C. § 1306(a)(7).

[61] 29 U.S.C. §§ 1302(b), 1362, 1367.

amount of missed contributions for a pension plan, including interest, exceeds $1 million;[62]

- the failure to satisfy the annual minimum required contribution for a pension plan's plan year will result in the imposition of substantial excise taxes owed to the IRS, initially ten percent of the amount of the unpaid contribution(s), and later increasing to 100 percent;[63]
- these eventualities often will harm relationships with lenders and prospective lenders, potential acquirers, potential strategic business partners, or current or potential investors, resulting in additional and often even more serious business problems and greatly reduced flexibility going forward, or may even result in an otherwise avoidable insolvency; and
- unpaid quarterly and annual contributions trigger various reporting and pension plan participant disclosure requirements, with exposure for penalties and for increased scrutiny by the PBGC, the IRS and the Department of Labor.[64]

To avoid or mitigate these pitfalls, if it appears that termination of the pension plan is necessary and appropriate, it is important to initiate a consultative process with qualified professionals so as to assess what the optimal course of action is and to address all potential liability and related issues proactively.

If timely invoked, the business continuation test could be the precise and surgical approach that enables a healthcare institution, company or system, be it for-profit or not-for-profit, to adjust and transform itself into one that can survive and thrive, and be far better able to focus on the essential role of providing the American public with critically needed healthcare.

Successfully navigating the thicket of ERISA's termination rules, distress or otherwise, is challenging, but also is doable. Indeed, it may be essential for an employer's survival.

[62] 26 U.S.C. § 430(k). The PBGC has the authority to perfect IRC Section 430(k) liens pursuant to notice filings with state and local governments. The filings are a matter of public record.

[63] 26 U.S.C. § 4971.

[64] 26 U.S.C. § 4971; 29 U.S.C. §§ 1021(d), 1310, 1343; 29 C.F.R. §§ 4010, 4043.

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