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PBGC Issues Guidance on Premium Penalty Waivers: Practitioners Beware!

By HAROLD J. ASHNER

Practitioners and their clients should carefully review the Pension Benefit Guaranty Corporation's recently issued policy guidance on premium penalty waivers.¹ The test to qualify for a "reasonable cause" waiver is relatively strict, with other types of waivers available only in very limited circumstances. Perhaps of most significance, the policy explicitly rejects any penalty relief based on the employer's or plan administrator's claim of good faith reliance on an outside advisor, such as an actuary or a lawyer, noting instead "the recourse that an organization may have against its outside advisors."² Particularly when coupled with recent legislative changes significantly increasing flat-rate premiums for all plans³ and variable-

rate premiums for many plans,⁴ the new policy suggests a high level of premium penalty exposure for all concerned.

Premium Penalty Assessment Rules

Although the policy does not address the assessment of premium penalties, a brief review of PBGC's assessment rules⁵ will provide useful context for its penalty waiver policy. These rules, which are subject to a statutory cap of 100 percent of the amount of unpaid premium,⁶ call for a penalty of 1 percent per month (for all months) on any amount of unpaid premium that is paid on or before the date PBGC issues a written notice to a liable party that there is or may be a premium delinquency (e.g., a premium bill, a letter initiating a premium compliance review, or a letter questioning a failure to make a premium filing). The rate quintuples to 5 percent (for all months) on any amount of unpaid premium that is paid after the date of such a written notice. For example, if an employer were to self-correct a \$500,000 premium underpayment 10 months after its due date, the penalty would be \$50,000, but the penalty would jump to \$250,000 if the correction were made one day after PBGC issued a written notice retroactively triggering the 5 percent rate. PBGC's rules thus provide a strong incentive to self-correct, and to do so quickly.

Under PBGC's regulations, the penalty for a premium underpayment is assessed automatically, without the need for PBGC staff to exercise any discretion as to whether or how much to assess. This is in sharp contrast to the assessment process under ERISA Section

¹ 71 Fed. Reg. 66867 (Nov. 17, 2006). The final rule is available at <http://edocket.access.gpo.gov/2006/pdf/E6-19436.pdf>.

² *Id.* at 66868.

³ See Section 8201 of the Deficit Reduction Act of 2005 (Pub. L. 109-171, Feb. 8, 2006).

Harold J. Ashner is a partner with Keightley & Ashner LLP, a Washington, D.C.-based law firm that specializes in PBGC matters. He previously served as assistant general counsel for legislation and regulations at PBGC. He left PBGC in early 2005 to form Keightley & Ashner LLP with James J. Keightley, PBGC's general counsel, and William G. Beyer, PBGC's deputy general counsel. For further information, visit <http://www.keightleyashner.com>.

⁴ See Section 401(a) of the Pension Protection Act of 2006 (Pub. L. No. 109-280, Aug. 17, 2006).

⁵ 29 CFR § 4007.8(a)(1).

⁶ ERISA § 4007(b).

4071 (“Penalty for Failure to Timely Provide Required Information”), in which PBGC staff exercise significant discretion in determining whether to pursue a penalty assessment and, if so, the appropriate amount of the assessment (subject to the statutory cap of \$1,100 per day for the delinquency period). The automatic, indeed mechanical, assessment of premium underpayment penalties makes PBGC’s waiver guidance in this area all the more important.

The Five Waiver Categories

The policy starts with the general statement that, “[i]n deciding whether to waive a premium penalty in whole or in part . . . , we consider the facts and circumstances of each case,” and then proceeds to list five categories of waivers, each of which is discussed in greater detail later in this article:

- “Provisions of law” waivers (where a statute or regulation requires the waiver).
- “Reasonable cause” waivers (the primary focus of the policy).
- “Legal errors” waivers (covering only certain kinds of legal errors).
- “Pendency of PBGC procedures” waivers (to the extent all or part of the premium penalty is attributable to the pendency of PBGC review or other procedures).
- “Other circumstances” waivers (a narrow “catch-all” category).

The policy makes no specific mention of a fairly common and significant form of penalty relief that is—at least in substance (though arguably not in form)—a penalty waiver: the relief PBGC provides through the various “disaster relief announcements” it issues throughout the year (e.g., 24 in the first 10 months of 2006). These announcements, available through the “Practitioners” page of PBGC’s website (<http://www.pbgc.gov>), are issued under the authority of ERISA Section 4002(i),⁷ which permits PBGC in certain circumstances to “prescribe . . . a period of up to 1 year which may be disregarded in determining the date by which any action is required or permitted to be completed under [ERISA].” A typical announcement will state that PBGC will “treat as timely” a qualifying premium filing,⁸ which literally means that a penalty is not even assessed and therefore need not be waived. (The typical announcement will go on, however, to state that, for a qualifying premium filing, PBGC “will waive the applicable penalty, but not the applicable interest charge.”⁹) The relief, of course, has the same effect as a penalty waiver. When facing a potential penalty for late payment of a premium, one should *always* check the PBGC’s disaster relief announcements *regardless* of whether the delay had anything to do with a disaster, as the typical announcement provides automatic relief for qualifying filings by plan administrators who are “located” in a specified “disaster area” without the need even for an allegation that the disaster had any effect on compliance efforts.¹⁰

⁷ ERISA Section 4002(i) was added by the Victims of Terrorism Tax Relief Act of 2001, Pub. L. No. 107-134, 115 Stat. 2427.

⁸ See, e.g., PBGC Disaster Relief Announcement 06-24.

⁹ *Id.*

¹⁰ *Id.*

Treatment of Outside Advisors

Regardless of the waiver category involved, PBGC has made clear its intent not to grant relief based on reliance on an outside advisor:

In some cases an accountant, actuary, lawyer, pension consultant, or other individual or firm that is not part of your organization may assist you in complying with PBGC requirements. If the outside individual’s or firm’s action, inaction, or advice causes or contributes to a failure to pay a premium in full and on time, we apply our waiver authority as if the outside individual or firm were part of your organization. In the case of an outside individual who is part of a firm, we generally consider both the individual and the firm to be part of your organization.

In the preamble to the final rule, PBGC explained the basis for its position on outside advisors as follows:

[O]rganizations with in-house advisors are treated the same in this respect as those that choose to retain outside advisors. Exercising care in selecting and monitoring advisors is not a basis for a reasonable cause waiver when the advisors are in-house; similarly, it is not considered a basis for a reasonable cause waiver where outside advisors are involved. Because it is so common for premium payers to use advisors in determining premiums, the payment of premiums could not adequately be enforced if premium penalties were waived in such circumstances. *Nothing in this final rule is intended to limit any recourse that an organization may have against its outside advisors.*

(Emphasis added.) The primary impact of PBGC’s position on outside advisors will of course be to limit the granting of “reasonable cause” waivers. In many cases, it will be the outside advisor who ends up paying the penalty, whether as a matter of good business practice or as a result of a threatened or filed lawsuit by the employer or plan administrator. However, there will also be many cases where the employer or plan administrator will face significant difficulties in obtaining reimbursement of the penalty, such as where there is a dispute as to whether the fault lies with the outside advisor. And the costs associated with obtaining reimbursement of the penalty through litigation may be too high to make the effort worthwhile, particularly in the case of small employers and small plans.

‘Provisions of Law’ Waivers

The policy notes that statutory or regulatory provisions may require a waiver in certain circumstances, and identifies three examples:

- “*Business hardship*” waiver. ERISA Section 4007(b) and implementing PBGC regulations¹¹ provide for a waiver in certain circumstances involving business hardship that would arise from timely payment of the premium, provided that the waiver is granted before the due date and the payment is made no more than 60 days late. These provisions are rarely, if ever, used.

- *Large plan “safe-harbor”* waiver. Far more common are waivers based on the “safe-harbor” relief in PBGC regulations¹² for the “estimated” flat-rate payment paid for large plans (i.e., those with 500 or more participants for the prior year) early in the plan year (by February 28 for calendar-year plans). Although the full, final flat-rate premium is owed by that early deadline,

¹¹ 29 CFR § 4007.8(b).

¹² 29 CFR § 4007.8(f)-(i).

the payment is often made on an estimated basis. Accordingly, PBGC regulations provide for automatic waivers in certain circumstances (e.g., where the estimate is based on 100 percent of the prior year's participant count) for estimated payments that fall short of the amount finally determined to be due.

■ **Billing "grace period" waiver.** PBGC regulations¹³ also provide for a 30-day "grace period" penalty waiver (along with the same 30-day grace period waiver for interest¹⁴) for premiums paid within 30 days after the date of a PBGC premium bill.

'Reasonable Cause' Waivers

Under the policy, the following two-part test applies to PBGC's reasonable cause determinations:

In general, there is "reasonable cause" for a failure to pay a premium in full and on time to the extent that—(1) The failure arises from circumstances beyond your control, and (2) You could not avoid the failure by the exercise of ordinary business care and prudence.

'Reasonable Cause' Guidance

PBGC elaborated on the "reasonable cause" test with significant additional guidance.¹⁵

Overlooking legal requirements. PBGC stated that "[o]verlooking legal requirements does not constitute reasonable cause." However, elsewhere in the policy, PBGC held out some hope for relief where what was overlooked was a recent change in the law, as discussed later in this article under "'Legal Errors' Waivers."

Reliance on outside advisors. As part of its general approach calling for a denial of relief requests that are based on reliance on an outside advisor, PBGC stated:

[T]here is generally no reasonable cause for a failure to pay a premium in full and on time that arises from circumstances within the control of the outside individual or firm, or could be avoided by the exercise of ordinary business care and prudence by the outside individual or firm. The fact that you exercised care and prudence in selecting and monitoring the outside individual or firm is not a basis for a reasonable cause waiver.

Effect of size. In evaluating reasonable cause, PBGC will consider both the size of the organization and the size of the premium underpayment:

■ **Size of organization.** PBGC explained that, where the responsibility for taking action rests with an organization or one or more of its employees, "the size of the organization may affect what ordinary business care and prudence would require." By way of example, PBGC noted that, "ordinary business care and prudence would typically require a larger organization to establish more comprehensive backup procedures than a smaller organization for dealing with situations such as computer failure, the loss of important records, and the inability of an individual to carry out assigned responsibilities."

■ **Size of premium underpayment.** PBGC also noted that, "[i]n general, the larger a premium, the more care and prudence you should use to make sure that you pay it in full and on time."

Collection/enforcement concerns. PBGC drew a distinction between its evaluation of reasonable cause and its collection and enforcement concerns, stating that, in determining whether reasonable cause exists, it does not consider either "[t]he likelihood or cost of collecting the premium penalty" or "[t]he costs and risks of enforcing the premium penalty by litigation." This certainly leaves PBGC free to decide not to pursue a penalty assessment based on collection or enforcement concerns (e.g., in a bankruptcy context), but such a decision would fall outside the scope of a reasonable cause determination. The result is the same, of course, whether PBGC provides relief through a reasonable cause determination or by settling or dropping a matter in light of collection or enforcement concerns, and it may well be worth exploring a non-"reasonable cause" resolution along such lines in appropriate cases.

Facts considered by PBGC. The policy provides a non-exhaustive listing of the kinds of facts PBGC considers in determining whether there is reasonable cause for a failure to pay a premium. This listing, which can serve as a very useful "road map" for anyone trying to persuade PBGC that reasonable cause exists, is as follows:

■ **Nature/timing of event/circumstance.** PBGC will consider "[w]hat event or circumstance caused the underpayment and when the event happened or the circumstance arose," and cautioned that "[t]he dates you give should clearly correspond with the underpayment upon which the premium penalty is based."

■ **Link to compliance failure.** PBGC will consider "[h]ow that event or circumstance kept you from paying the premium in full and on time," and added that the explanation "should relate directly to the failure to pay a premium that is the subject of the premium penalty."

■ **Ability to anticipate.** PBGC will consider "[w]hether you could have anticipated the event or circumstance."

■ **Nature of response.** The final item in this non-exhaustive listing calls for PBGC to consider "[h]ow you responded to the event or circumstance, including what steps you took, and how quickly you took them, to pay the premium and how you conducted other business affairs." PBGC explained that "[k]nowing how you responded to the event or circumstance may help us determine what degree of business care and prudence you were capable of exercising during that period and thus whether the failure to pay the premium could or could not have been avoided by the exercise of ordinary business care and prudence." (The message here appears to be that PBGC may not react favorably if the premium obligation were afforded a lower priority than most or all other obligations.)

Common 'Reasonable Cause' Situations

The policy provides a far more detailed "road map" through four examples of situations involving reasons that are "often given" to PBGC for premium delinquencies and that "may constitute reasonable cause."¹⁶ Each example includes a tailored listing of the kinds of factors PBGC considers in the situation presented. For practitioners dealing with an analogous situation, this detailed listing can be an invaluable aid in preparing a successful waiver application.

¹³ 29 CFR § 4007.8(e).

¹⁴ 29 CFR § 4007.7(b).

¹⁵ 71 Fed. Reg. at 66870.

¹⁶ *Id.* at 66870-71.

Responsible individual's sudden/unexpected absence or inability to act. Where “[a]n individual with responsibility for taking action was suddenly and unexpectedly absent or unable to act,” PBGC considers such factors as:

- *Nature of causative event.* “The nature of the event that caused the individual’s absence or inability to act, for example, the resignation of the individual or the death or serious illness of the individual or a member of the individual’s immediate family.”

- *Organization’s size and backup procedures.* “[T]he size of the organization and what kind of backup procedures it had to cope with such events.”

- *Proximity to deadline.* “[H]ow close the event was to the deadline that was missed.”

- *Ability to anticipate event.* “[H]ow abrupt and unanticipated the event was.”

- *Link to compliance failure.* “[H]ow the individual’s absence or inability to act prevented compliance.”

- *Expense of alternate compliance.* “[H]ow expensive it would have been to comply without the absent individual.”

- *Impact on other operations/obligations.* “[W]hether and how other business operations and obligations were affected.”

- *Timing/prudence of alternative arrangements selected.* “[H]ow quickly and prudently a replacement for the absent individual was selected or other arrangements for compliance were made.”

- *Speed of action by replacement personnel.* “[H]ow quickly a replacement for the absent individual took appropriate action.”

Disaster causing record destruction or otherwise preventing compliance. Where “[a] fire or other casualty or natural disaster destroyed relevant records or prevented compliance in some other way,” PBGC considers such factors as:

- *Nature of causative event.* “The nature of the event.”

- *Proximity to deadline.* “[H]ow close the event was to the deadline that was missed.”

- *Link to compliance failure.* “[H]ow the event caused the failure to pay the premium.”

- *Alternative compliance efforts.* “[W]hether other efforts were made to get needed information.”

- *Expense of compliance.* “[H]ow expensive it would have been to comply.”

- *Nature of response.* “[H]ow you responded to the event.”

Reliance on erroneous advice by PBGC employee. Where “[y]ou reasonably relied on erroneous oral or written advice given by a PBGC employee,” PBGC considers such factors as:

- *Relationship of advice to situation.* “Whether there was a clear relationship between your situation and the advice sought.”

- *Full disclosure to PBGC employee.* “[W]hether you provided the PBGC employee with adequate and accurate information.”

- *Reasonableness of reliance.* “[W]hether the surrounding circumstances should have led you to question the correctness of the advice or information provided.” (This factor suggests, among other things, that PBGC is trying to discourage “forum shopping,” i.e., calling different PBGC employees until one finally provides the desired advice.)

Inability to obtain necessary information. Where “[y]ou were unable to obtain information, including records and calculations, needed to comply,” PBGC considers such factors as:

- *Information needed.* “What information was needed.”

- *Reason for unavailability.* “[W]hy the information was unavailable.”

- *Timing/manner of discovery of unavailability.* “[W]hen and how you discovered that the information was not available.”

- *Attempts to obtain/reconstruct information.* “[W]hat attempts you made to get the information or reconstruct it through other means.”

- *Expense of compliance.* “[H]ow much it would have cost to comply.”

Partial ‘Reasonable Cause’ Situations

PBGC also noted two situations that “might justify” a partial “reasonable cause” waiver:¹⁷

Reasonable cause for part of delay. Where “a fire destroyed the records needed to compute a premium payment” and “in the exercise of ordinary business care and prudence it should take you one month to reconstruct the records and pay the premium, but the payment was made two months late,” PBGC concluded that “it might be appropriate to waive that part of the premium penalty attributable to the first month the payment was late, but not the part attributable to the second month.”

Reasonable cause for part of underpayment. Where a plan administrator underpaid the plan’s flat-rate premium “because of reasonable reliance on erroneous advice from a PBGC employee” and also underpaid the plan’s variable-rate premium “because the plan actuary used the wrong interest rate,” and PBGC concluded that “[w]hile the erroneous PBGC advice constituted reasonable cause for underpaying the flat-rate premium, there was no showing of reasonable cause for the error in the variable-rate premium,” PBGC “would waive only the part of the premium penalty based on underpayment of the flat-rate portion of the premium.”

‘Legal Errors’ Waivers

The policy provides relief from penalties where the premium payment failure results from certain kinds of legal errors, with significantly greater prospects for relief if the erroneous legal error is disclosed to PBGC or involves a recent change in the law.¹⁸

Erroneous legal interpretation—disclosed. The policy states that PBGC “will” waive the penalty if the failure results from reliance on an erroneous interpretation of the law, where “you promptly and adequately call our attention to the interpretation and the relevant facts, and the erroneous interpretation is not frivolous.” The manner of such a “prompt[] and adequate” notification to PBGC depends on whether the filing affects a filing made with PBGC; if so, “you should call our attention to the interpretation in writing with the filing,” but if one relies on the interpretation to justify not making a

¹⁷ *Id.* at 66870-71.

¹⁸ *Id.* at 66869-70.

filing with PBGC, “you should call our attention to the interpretation in writing by the time prescribed for the filing not made.”

Erroneous legal interpretation—undisclosed. The bar is much higher where the reliance is on an erroneous interpretation of the law that one *does not* “promptly and adequately disclose” (along with the relevant facts) to PBGC. In that situation, in lieu of PBGC promising that it “will” waive the penalty if “the erroneous interpretation is not frivolous,” the policy provides only that PBGC “may” waive the penalty “if the weight of authority supporting the interpretation is substantial in relation to the weight of opposing authority and it is reasonable for you to rely on the interpretation.” The incentive to disclose, rather than to “play the audit lottery,” is clear, and should help PBGC—which presumably has neither the resources nor the desire to audit most or all premium filings—ferret out some of the more aggressive positions being taken on premium-related issues.

Recent change in the law. Finally, the policy provides that PBGC “may waive all or part of” a premium penalty “if the law changes shortly before the date a premium payment is due and the premium payment that you make by the due date would have been correct under the law as in effect before the change.” In making these waiver determinations, PBGC considers such factors as:

- *Proximity of change to deadline.* “[T]he length of time between the change in the law and the premium due date.”

- *Publicity of change.* “[T]he nature and timing of any publicity given to the change in the law.”

- *Complexity of legal issues.* “[T]he complexity of the legal issues.”

- *Familiarity with legal issues.* “[Y]our general familiarity with those issues.” (Where significant “familiarity” rests with an outside advisor, PBGC is likely to take that familiarity into account, given its stated intention to apply its waiver authority “as if the outside individual or firm were part of your organization.”¹⁹)

‘Pendency of PBGC Procedures’ Waivers

The policy states that PBGC also “may waive all or a part of” a premium penalty where the delinquency “is attributable to the pendency of PBGC review or other procedures,” and offers two helpful examples.²⁰

Certain delays pending PBGC review. Where a request for review of a premium penalty is based on “a non-frivolous argument . . . that you were not required to pay the premium or that you were, and still are, unable to obtain the information needed to determine the premium,” PBGC “may waive the portion of the premium penalty that accrues during the review process.” And where such a non-frivolous argument is made only “with respect to a portion of the premium,” PBGC “may apply this principle to that portion.”

Certain delays in notification by PBGC. If PBGC “believe[s] that the pendency of PBGC procedures for identifying a premium delinquency and notifying you of the delinquency contributed to your failure to correct

the delinquency more promptly,” PBGC “may waive all or a part of [the] premium penalty.”

‘Other Circumstances’ Waivers

Finally, the policy contains a “catch-all” waiver category, albeit a narrow one. Under this final category, PBGC “may waive all or part of a premium penalty in other circumstances if we determine that it is appropriate to do so,” but “intend[s] to exercise this waiver authority only in narrow circumstances.”²¹ Clearly, the balance for PBGC here is to preserve its own flexibility to waive penalties without giving those on the receiving end of penalties too broad a “catch-all” category to use in arguing that a waiver is required.

Just how narrow this category will prove to be is uncertain. When PBGC issued its penalty policy in proposed form in 2001, it stated that it intended to exercise its “other circumstances” waiver authority “primarily if we determine that assessing a premium penalty, or assessing the full amount of a premium penalty, would be inconsistent with the purposes of Title IV of ERISA.”²² The final version dropped this language because it “conveys a standard more restrictive than PBGC now considers appropriate,”²³ thereby suggesting a somewhat broader reach. On the other hand, the proposed version included, as an example of an “other circumstances” waiver, that PBGC “may waive all or part of a premium penalty if a premium underpayment reflected on a premium form is insignificant and is caused by an inadvertent mathematical error (such as a transposition of digits) on the form,” but the final version dropped this example without explanation,²⁴ thereby suggesting a narrower reach at least in the context of this kind of example.

However narrowly or broadly PBGC may intend to apply this “catch-all” waiver authority, it is a potentially useful category for practitioners to rely on in requesting penalty relief where the first four categories offer little hope for success.

Effective Date of Policy

The policy is effective Dec. 18, 2006, and applies to PBGC actions taken on or after that date.²⁵ It thus appears that PBGC intends to apply the new policy to pending cases.

Conclusion

With PBGC premiums on the increase and the issuance of a relatively strict PBGC policy on waiver of premium penalties, the importance of timely paying the correct premium cannot be overstated. Nonetheless, there will inevitably be premium delinquencies, along with the resulting automatic PBGC penalty assessments. The new PBGC policy contains significant guidance to aid the practitioner in preparing a request for PBGC to provide partial or full penalty relief in the form of a waiver.

²¹ *Id.*

²² 66 Fed. Reg. 2856, 2860 (Jan. 12, 2001).

²³ 71 Fed. Reg. at 66868.

²⁴ *See id.*

²⁵ *Id.* at 66867.

¹⁹ *Id.* at 66870.

²⁰ *Id.*