

AN OVERVIEW OF ERISA AND THE PBGC⁶³

On Labor Day 1974,⁶⁴ President Gerald Ford signed into law the Employee Retirement Income Security Act of 1974,⁶⁵ now commonly known by its acronym “ERISA.” This “comprehensive and reticulated” statute⁶⁶ represented the culmination of 10 years of studies, hearings, debates and findings by the congressional labor and tax committees, and was designed to provide a complete system of federal regulation of private employee benefit plans.⁶⁷

I. ORGANIZATION AND ADMINISTRATION OF ERISA

ERISA is organized into four titles. Title I added new subchapters I and II to Chapter 18 of Title 29 of the U.S. Code,⁶⁸ adopting requirements for the reporting and disclosure of financial information to both plan participants and the government,⁶⁹ establishing minimum participation, accrual and vesting rules for plans,⁷⁰ prescribing minimum funding requirements for plans and their sponsors,⁷¹ and setting out fiduciary obligations for those having any

63 This chapter of the *Pension Manual* was authored by William G. Beyer. Portions of this chapter were recently published in Beyer, William G., *Pensions, Bankruptcy, and the Pension Benefit Guaranty Corporation*, 2005 ANNUAL SURVEY OF BANKRUPTCY LAW, and are used with permission of the publisher Thomson West.

64 Sept. 2, 1974.

65 Pub. L. No. 93-406, 88 Stat. 829 (1974).

66 *Nachman Corp. v. PBGC*, 446 U.S. 359, 361 (1980).

67 *Id.* This includes employee pension benefit plans (defined benefit and defined contribution) and employee welfare benefit plans (health, life insurance, severance, etc.). See 29 U.S.C.A. §1002(1)–(3) (Thomson West 2006). All references herein to the U.S. Code are made to the unofficial *United States Code Annotated* published by Thomson West in 2006. This version reflects the most recent changes to the Code.

68 29 U.S.C.A. §§1001-1191.

69 These provisions are under the jurisdiction of the Department of Labor.

70 These provisions are under the jurisdiction of the Treasury Department and are administered by the Internal Revenue Service.

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discretion over the operation of plans or the control of their funds.⁷² It also created broad enforcement jurisdiction in the federal courts and, in some cases, concurrent jurisdiction in state courts.⁷³

Title II amended the Internal Revenue Code by adopting provisions parallel to those in Title I but that govern tax consequences for compliance or noncompliance with those provisions.⁷⁴

Title III sets out housekeeping rules covering cooperation among the agencies (among other things).

Title IV added a new subchapter III to chapter 18 of Title 29 of the U.S. Code, establishing the termination insurance program for private sector defined benefit pension plans and creating a new federal agency, the Pension Benefit Guaranty Corporation (PBGC) as the insurer of benefits promised by those plans.⁷⁵

There may be ERISA issues in any bankruptcy case in which the debtor (or an affiliate of the debtor⁷⁶) maintains an employee benefit plan. The Internal Revenue Service will pursue tax-related claims, including those that are related to employee plans, while the Department of Labor will pursue remedies for fiduciary breaches related to employee plans. If a defined benefit pension

71 *Id.*

72 These provisions are under the jurisdiction of the Department of Labor.

73 See ERISA §§502-506, 29 U.S.C.A. §§1132-36.

74 See, e.g., IRC §§401-501.

75 See ERISA §§4001-4402 29 U.S.C.A. §§1301-1461.

76 ERISA includes a comprehensive “controlled group” definition under which certain affiliates of a company are treated as though each were the employer maintaining each plan. See ERISA §4001(a)(14), 29 U.S.C.A. §1301(a)(14); I.R.C. §414(b), (c). The implications of being a member of a controlled group will be discussed in subsequent chapters.

plan is among the plans, the PBGC can be expected to enter its appearance in the case and, depending on the financial condition of the pension plan and the debtor, may choose to be a major participant.⁷⁷ If an underfunded plan is terminated, PBGC will pursue claims for the underfunding and will become the plan's trustee. As trustee, it will pursue claims for unpaid employer contributions and fiduciary breach damages on behalf of the plan.

II. THE PBGC

The PBGC is a corporation wholly owned by the United States, modeled after the Federal Deposit Insurance Corporation.⁷⁸ It enjoys the benefits of being both a corporation and an agency of the federal government. Like a business entity, it has “the powers conferred on a nonprofit corporation under the District of Columbia Nonprofit Corporation Act,”⁷⁹ with a specific statutory grant of broad powers to deal with property⁸⁰ and to enter into contracts.⁸¹ Unlike other government entities, it is expressly empowered “to sue and be sued, complain and defend, in its corporate name and through its own counsel, in any court, State or

77 The PBGC may seek appointment to the official committee of unsecured creditors in a chapter 11 case where it feels its expertise might enhance recoveries in the case (for its own benefit and for the benefit of all other stakeholders). It is the only governmental entity permitted to become a voting member of committees. See Bankruptcy Code §§101(41)(B), 1102(b) (definition of “person”).

78 See *PBGC v. LTV Corp.*, 496 U.S. 633, 637 (1990).

79 ERISA §4002(b), 29 U.S.C.A. §1302(b).

80 ERISA §4002(b)(5), 29 U.S.C.A. §1302(b)(5): the power “to lease, purchase, accept gifts or donations of or otherwise to acquire, to own, hold, improve, use or otherwise deal in or with, and to sell, convey, mortgage, pledge, lease, exchange or otherwise dispose of, any property, real, personal or mixed, or any interest therein wherever situated.”

81 ERISA §4002(b)(8), 29 U.S.C.A. §1302(b)(8): the power “to enter into contracts, to execute instruments, to incur liabilities, and to do any and all other acts and things as may be necessary or incidental to the conduct of its business and the exercise of all other rights and powers granted to the corporation by this chapter [ERISA].”

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Federal.”⁸² This so-called independent litigating authority permits the PBGC to independently take Title IV actions up to and including the Supreme Court. This power, together with a broad grant of settlement authority,⁸³ permits it to act independently and quickly without the multiple layers of government concurrences other agencies may need to work within.

On the other hand, the PBGC has several advantages as a government agency. For example, it operates outside of regulation or taxation by the states,⁸⁴ may issue regulations that have the force of law,⁸⁵ may issue subpoenas to aid its enforcement of Title IV⁸⁶ and may bring actions in federal court regardless of the amount in controversy while using nationwide service of process.⁸⁷ Where enforcement or interpretation of Title IV provisions has been involved, its views are solicited and accorded deference by the courts.⁸⁸

82 ERISA §4002(b)(1), 29 U.S.C.A. §1302(b)(1).

83 ERISA §4067, 29 U.S.C.A. §1367: “The corporation is authorized to make arrangements with contributing sponsors and members of their controlled groups who are or may become liable under §§1362, 1363 or 1364 of this title for payment of their liability, 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.”

84 ERISA §4002(b)(4), (g), 29 U.S.C.A. §1302(b)(4), (g).

85 Its broad, general grant of authority is found in ERISA §4002(b)(3), 29 U.S.C.A. §1302(b)(3). Specific grants are found throughout Title IV. *See, e.g.*, ERISA §§4010(a), 4011(a), 4043(c)(13), 4063(b), 4064(b); 29 U.S.C.A. §§1310(a), 1311(a), 1343(c)(13), 1363(b), 1364(b).

86 ERISA §4003(a); 29 U.S.C.A. §1303(a).

87 ERISA §4003(e)(2), (3), 29 U.S.C.A. §1303(e)(2), (3).

88 *See, e.g., PBGC v. LTV Corp.*, 496 U.S. 633, 642-43, 647-48 (1990) (according *Chevron* deference to the PBGC’s interpretation of the requirements for its restoring a terminated plan under ERISA §4047); *see also Mead Corp. v. Tilley*, 490 U.S. 714, 727 (1989) (“In deciding these issues [on remand], the court of appeals should consider the views of the PBGC and the IRS. For a court to attempt to answer these questions without the views of the agencies responsible for enforcing ERISA, would be to ‘embar[k] upon a voyage without a compass.’”).

Administratively, the PBGC is governed by a board of directors consisting of the Secretaries of Labor, Treasury and Commerce, with the Secretary of Labor as chairman.⁸⁹ The responsibility for carrying out the functions of the PBGC is vested in its director, an individual “appointed by the President, by and with the advice and consent of the Senate.”⁹⁰ The agency is small and centralized, with all its operations in Washington, D.C.⁹¹ It maintains a comprehensive Web site containing explanation of its program with answers to frequently asked questions, and the full text of its regulations and downloadable versions of its prescribed forms and their instructions.⁹²

The PBGC was designed to be financially self-sustaining and receives no funds from general tax revenues. Its operations are financed largely by insurance premiums paid by companies that sponsor pension plans⁹³ and by returns on the investment of those funds and funds assumed upon its takeover of failed pension plans. It also invests amounts recovered on its claims against sponsoring employers and their controlled groups (claims it asserts both as insurer and as successor trustee of terminated underfunded plans).⁹⁴

89 ERISA §4002(d); 29 U.S.C.A. §1302(d).

90 ERISA §4002(a); 29 U.S.C.A. §1302(a) *as amended by* §411 of the Pension Protection Act of 2006, Pub. L. No. 109-280, 120 Stat. 780 (2006) [hereinafter “Pension Protection Act”].

91 It utilizes the services of a number of contractors in areas where retirees entitled to benefits from its insurance program are concentrated, for assistance in administration of benefit payments.

92 See www.pbtc.gov.

93 Premiums will be discussed *infra*.

94 See ERISA §§4042(d)(1), 4062(a)-(c); 29 U.S.C.A. §§1342(d)(1), 1362(a)-(c). PBGC and plan fiduciary claims are fully explained in Chapters 5 and 6, respectively.

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In apparent recognition that it is the party having the greatest financial interest, Congress departed from the jurisdictional pattern and relegated to PBGC concurrent jurisdiction over enforcement of minimum funding for Title IV-covered plans. Where an employer misses a required minimum funding payment and the total of all missed payments (including interest) exceeds \$1 million, a lien arises in favor of the plan automatically on all controlled group property in that amount. The lien is perfected and enforced by the PBGC.⁹⁵

III. THE PLAN TERMINATION INSURANCE PROGRAM

With the enactment of Title IV of ERISA, Congress created a safety net for participants in private sector, tax-qualified, defined-benefit pension plans.⁹⁶ The Supreme Court in an early PBGC case noted: “One of Congress’ central purposes in enacting this complex legislation was to prevent the ‘great personal tragedy’ suffered by employees whose vested benefits are not paid when pension plans are terminated.”⁹⁷ The PBGC administers the insurance program and enforces the rules governing termination of plans covered by the Title. Coverage by the program is mandatory; although there is no law mandating adoption of a pension plan, once that business decision has been made and implemented, these requirements will apply.

95 ERISA §§302(f), 4003(e)(1), 29 U.S.C.A. §§1082(f), 1303(e)(1); IRC §412(n). If PBGC perfects pre-petition, the claim will be treated as a secured claim. As a statutory lien, it is exempt from avoidance as a preference even if the preference elements are met. 11 U.S.C.A. §547(c)(6).

96 ERISA §4021(a), 29 U.S.C.A. §1321(a). Some plans are exempt from coverage, *e.g.*, plans maintained by government entities or religious organizations. ERISA §4021(b), 29 U.S.C.A. §1321(b).

97 *Nachman Corp. v. PBGC*, 446 U.S. 359, 374 (1980). The quotation included in the Court’s opinion is from a statement by Sen. Lloyd Bentsen, the member of the Senate Committee on Finance most active in sponsoring ERISA.

The plan termination insurance program covers both multi-employer and single-employer pension plans.⁹⁸ Because PBGC has a more limited role under the multi-employer insurance program than under the single-employer program, this chapter will provide only a quick overview of that program. Chapter 7 will provide a more comprehensive treatment of multi-employer plans.

multi-employer plans are plans to which more than one employer is required to contribute and which are maintained pursuant to one or more collective bargaining agreements between one or more employee organizations and more than one employer.⁹⁹ Under Title IV, multi-employer plans have a set of rules unique to their structure.¹⁰⁰ The goal of those rules is to foster continuation of multi-employer plans by requiring payment of “withdrawal liability” to the plan by any participating employer that ceases to be obligated to contribute to the plan, in an amount generally related to the employer’s proportionate share of the plan’s unfunded vested benefits.¹⁰¹ Rather than terminate, the plan continues, financed by collection of withdrawal liability and the contributions of the remaining employers. PBGC becomes involved if a multi-employer plan becomes insolvent, *i.e.*, unable to pay basic pension benefits when due; the agency then provides financial assistance to the plan from its insurance funds.¹⁰² multi-employer plans are governed by a joint board of trustees made up of repre-

98 At the close of 2005, the multiemployer program covered almost 10 million participants in 1,567 plans; the single-employer program covered 34.2 million participants in 28,769 plans. *See Pension Insurance Data Book 2005* (PBGC, Aug. 16, 2006) [hereinafter “2005 PBGC Data Book”].

99 ERISA §4001(a)(3), 29 U.S.C.A. §1301(a)(3).

100 ERISA §4201-4402, 29 U.S.C.A. §1381-1461.

101 ERISA §4201, 29 U.S.C.A. §1381.

102 ERISA §4261, 29 U.S.C.A. §1431.

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sentatives of both labor and management. If the withdrawing employer is a bankrupt debtor, the joint board of trustees pursues the claim for withdrawal liability.¹⁰³

The single-employer plan¹⁰⁴ program insures vested, basic pension benefits¹⁰⁵ upon termination of a covered plan having assets insufficient to cover those benefits.¹⁰⁶ Unlike Social Security, which prescribes the benefit it will provide, the Title IV guarantee is keyed to the benefit of each individual under the terms of his or her individual plan. The guarantee is not absolute, however; it is subject to some statutory limitations. For example, the guarantee of benefit increases adopted or becoming effective within five years of plan termination is phased in at 20 percent per year.¹⁰⁷ Guaranty of so-called “shutdown benefits,” subsidized benefits whose entitlement is triggered by an “unpredictable contingent event,” such as a plant shutdown, are phased in over five years from the date of the event.¹⁰⁸ Guaranty of benefits of a “majority owner” of the employer are phased in over the 10 years following the later of the adoption or effective date of the plan.¹⁰⁹ And the guarantee is subject to a cap, set annually and applicable to all plans terminating in that year.¹¹⁰ Once a plan terminates, that plan’s “maximum insurance

103 A large body of case law has developed involving claims by joint boards of multiemployer plans. This topic is explored in more detail in Chapter 7.

104 Single-employer plans are all plans that are not multiemployer plans (and so include “multiple employer” plans, *e.g.*, plans that would be multiemployer plans but are not collectively bargained). ERISA §4001(a)(15), 29 U.S.C.A. §1301(a)(15).

105 Basic pension benefits are benefits whose purpose is to provide substantially level payments to a plan participant upon retirement for his or her remaining life. 29 C.F.R. §4022.2. Therefore, temporary supplements and nonpension ancillary benefits (such as health or life insurance) that may be promised in a pension plan are not guaranteed.

106 ERISA §4022(a), 29 U.S.C.A. §1322(a).

107 ERISA §4022(b)(1), (7), 29 U.S.C.A. §1322(b)(1), (7).

108 ERISA §4022(b)(8), 29 U.S.C.A. §1322(b)(8), *as amended by* Pension Protection Act, §403.

109 “Majority owner” is an individual who owns 50 percent or more of the entity. ERISA §4022(b)(5), 29 U.S.C.A. §1322(b)(5), *as amended by* Pension Protection Act, §407.

110 ERISA §4022(b)(3), 29 U.S.C.A. §1322(b)(3).

limit” is fixed and does not change. The limit is adjusted annually based on changes in the social security contribution and benefit base. The maximum guaranteed benefit for participants in plans terminating in 2006 is \$47,659.08 yearly (\$3,971.59 monthly) for a single-life annuity beginning at age 65. The maximum is actuarially adjusted downward for retirees younger than age 65 or for benefits paid in forms other than a single-life annuity.¹¹¹

The Pension Protection Act added a new limit on the guarantee, triggered by a plan sponsor’s bankruptcy case. While in all other cases the plan termination date is the date fixed for measurement of each participant’s guaranteed benefit, in the event of a sponsor’s Title 11 case initiated 30 days after the date of enactment of the Pension Protection Act (August 17, 2006), the petition date is substituted for the plan termination date for purposes of determining the Title IV guarantee. Post-petition benefit accruals therefore will not be guaranteed.¹¹²

The insurable event under Title IV is plan termination.¹¹³ If a plan has funds sufficient to provide all promised benefits through purchase of annuities from an insurer (or provide benefits in another form, *e.g.*, a single lump sum, allowed by the plan and elected by the participant), the employer may terminate the plan as of right in a “standard termination.”¹¹⁴ If the plan does not have sufficient

111 While the maximum insurance limit might seem low, “[e]xcept for well-publicized instances, such as in the airline industry—where pilots and others at carriers under bankruptcy protection have had to take a cut from the six-figure retirement packages they were owed—90 percent of workers paid by the PBGC get 100 percent of what they were due.” Day, Kathleen, “Retirement Squeezed: As Traditional Plans Decline, Workers Face a Less Certain Future,” *The Washington Post*, Sept. 17, 2006, at F01.

112 ERISA §4022(g), 29 U.S.C.A. §1322(g), *as amended by* Pension Protection Act, §404.

113 ERISA §4022(a), 29 U.S.C.A. §1322(a).

114 ERISA §4041(b), 29 U.S.C.A. §1341(b). If termination is prohibited by the terms of a collective bargaining agreement, termination must be negotiated or, if the employer is a debtor in a bankruptcy case, the agreement rejected. ERISA §4041(a)(3), 29 U.S.C.A. §1341(a)(3).

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assets, it may only be terminated by the employer in a “distress termination,” provided that the required burden of proof can be met.¹¹⁵ PBGC may, upon making one of the required statutory determinations,¹¹⁶ exercise its discretion to “involuntarily” terminate a plan. If PBGC determines that a plan does not have assets available to pay benefits currently due, it must involuntarily terminate the plan.¹¹⁷ Plan termination will be dealt with in detail in Chapters 3 and 4.¹¹⁸

Upon termination in a distress or involuntary termination, PBGC will seek its appointment as statutory plan trustee, either by agreement or court order.¹¹⁹ Upon appointment, all plan assets will be transferred to PBGC, which will administer them in a commingled trust made up of assets of all trustee plans,¹²⁰ take over plan records and assume responsibility for payment of benefits. As trustee, PBGC has all of the powers of the plan’s fiduciaries as well as additional broad statutory powers.¹²¹

As noted above, PBGC’s primary sources of funds lie in the premiums it collects from covered plans and the assumption of terminat-

115 ERISA §4041(c), 29 U.S.C.A. §1341(c). The same collective bargaining rule applies as in a standard termination.

116 ERISA §4042(a)(1)-(4), 29 U.S.C.A. §1342(a)(1)-(4).

117 ERISA §4042(a), 29 U.S.C.A. §1342(a).

118 While much notoriety has accompanied termination of several very large plans maintained by well-known companies, in the history of the plan termination insurance program, of the more than 170,000 terminations, some 166,500 were standard terminations and only 3,855 were trustee terminations of underfunded plans. 2005 PBGC Data Book, Table S-3.

119 ERISA §4042(c), 29 U.S.C.A. §1342(c). Most “involuntary” terminations are concluded by agreement between the plan administrator and the PBGC. Where agreement cannot be reached, PBGC may proceed in U.S. District Court seeking a termination decree; the automatic stay will not apply to the action. ERISA §4042(c),(e)-(g), 29 U.S.C.A. §1342(c),(e)-(g).

120 ERISA §4042(a), 29 U.S.C.A. §1342(a), expressly permits PBGC to commingle the assets of all trustee plans.

121 See ERISA §4042(d)(1), 29 U.S.C.A. §1342(d)(1).

ed, trustee plan assets, as well as investment income on those funds. As a result of the termination of several large, severely underfunded plans, combined with low interest rates and poor market returns, PBGC ended 2005 in a deficit position in both the single-employer and multi-employer programs.¹²²

Congress acted recently to bolster PBGC's financial position in a number of ways, including raising the amount of premiums it collects.¹²³ Prior to these amendments, the single-employer plan premium was comprised of two components: a flat rate of \$19 per plan participant per year (all single-employer plans), and a variable rate of \$9 per \$1,000 of unfunded vested benefits (underfunded single-employer plans). The multi-employer plan premium was a flat rate of \$2.60 per participant per year with no variable component.¹²⁴ The Deficit Reduction Act of 2005 changed those premiums by increasing the single-employer flat rate to \$30 per plan participant per year and the multi-employer flat rate to \$8 per participant per year. The single-employer variable rate was not changed. The new rates became effective for plan years beginning on and after Jan. 1, 2006, and are indexed to changes in the social security national average wage index beginning in 2007.¹²⁵ These changes are intended to have an immediate, positive effect on PBGC's bottom line.

122 These deficits were \$22.8 billion and \$335 million respectively. *PBGC 2005 Annual Report* at 2.

123 Although the plan termination insurance program is not backed by the full faith and credit of the United States, ERISA §4002(g)(2) and 29 U.S.C.A. §1301(g)(2), questions have been raised as to the possibility of a taxpayer bailout should the agency fail.

124 ERISA §4006(a)(3), 29 U.S.C.A. §1306(a)(3). "An individual is considered to be a participant in a plan on any date if the plan has benefit liabilities with respect to the individual" and so includes active participants as well as former employees with vested benefits, retirees, beneficiaries of deceased participants and alternate payees under qualified domestic relations orders. See 29 C.F.R. §4006.6.

125 See §2201, Deficit Reduction Act of 2005, Pub. L. No. 109-171, 120 Stat. 4 (2006) [hereinafter "DRA 2005"].

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In addition, Congress enacted changes to the funding rules in Title I of ERISA and the Internal Revenue Code, requiring accelerated payments to reduce underfunding in defined benefit plans, and restricting benefit increases and certain distributions based on the funding level of a plan.¹²⁶ These changes are intended to have a positive effect in the longer term, causing plans to become better funded and, therefore, less likely to need termination, or if terminated, having smaller shortfalls for PBGC to absorb.¹²⁷

DRA 2005 also added an “exit fee” or “termination premium” in the amount of \$1,250 per participant for each of three years, payable by the plan sponsor following termination of its underfunded plan.¹²⁸ Evidently to defend against the assertion that this assessment might be discharged, the first payment is not due until after the debtor’s discharge from bankruptcy.¹²⁹ Though termination of an underfunded plan is available to a debtor who proves that its pension plan is unaffordable, termination still gives rise to what in many cases has been the largest claim in the case, with PBGC as the largest creditor.¹³⁰ It is prudent to notify PBGC early in the planning to minimize potential conflicts with the agency as restructuring proceeds.¹³¹

126 Pension Protection Act, §§101-116.

127 These changes may also result in more plan terminations in the short term. Where a plan was only marginally affordable before the changes, the newly required increased cash flow may render it unaffordable and the sponsor eligible for a distress termination. *See Day, Retirement Squeezed, supra*, n. 110.

128 The “exit fee” doubles to \$2,500 if the sponsor is an airline that elected to use the special airline funding relief provided by §402 of the Pension Protection Act.

129 ERISA §4006(a)(7), 29 U.S.C.A. §1306(a)(7) *as added by* DRA 2005, §2201.

130 *See* ERISA §4062(a)–(c), 29 U.S.C.A. §1362(a)–(c). Statutory claims for plan underfunding and the trustee’s claims for unpaid minimum funding and fiduciary breaches, if any, will be discussed in Chapters 5 and 6, respectively.

131 Commencement of a bankruptcy case is an ERISA “reportable event” that must be reported to PBGC under ERISA §4043(c)(10), 29 U.S.C.A. §1343(c)(10) and 29 C.F.R. §§4043.35, 4043.68.