NRLN
NATIONAL RETIREE
LEGISLATIVE NETWORK

Pension Spin-offs

Protecting Retirees from Financial Engineering and Foreign Acquisition

Table of Contents

Executive Summary

For workers, retirees and taxpayers alike, the stakes are high when an under-funded pension plan is terminated or abandoned. Despite the partial benefit guarantees provided by the Pension Benefit Guarantee Corporation (PBGC), when an under-funded pension plan terminates it imposes an *immediate and permanent loss of income* on many retirees and other plan participants. The permanent loss of vested but *non-guaranteed* benefits, due to various PBGC limitations, can be devastating to the individuals affected. The PBGC itself reports that the proportion of participants negatively impacted has tripled over the past decade – and the share of vested benefits permanently lost has risen substantially to 28% on average per participant.

Certain corporate transactions – particularly the spin-off of under-performing subsidiaries – greatly increase the risk of distress termination and benefit losses for retirees. The strategic spin-off of an under-performing unit is a well-established tactic that holds even greater appeal when legacy pension, health and welfare benefits can be taken off the books of the parent company. Preventing under-funding of plans – and taking action to avoid terminations that trigger losses for both retirees and the PBGC – needs to be a higher policy priority for Congress and the Administration. To not do so unnecessarily increases the risk of permanent pension losses for plan participants to an unacceptable level.

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

Unfortunately, the PBGC and other federal regulators lack the tools to protect retirees from unnecessary – and unnecessarily severe – terminations. ERISA's outdated and narrow protections create a number of gaps that will do increasing harm to both retirees and to the PBGC's reported deficits unless Congress enacts at least a few modest changes. To its credit the agency in recent years has become more aggressive in using its very limited statutory levers to negotiate additional contributions that at least delay or mitigate the negative impacts of a distress termination. However, these tools are neither broad enough in scope nor flexible enough with respect to the remedies available when dealing with an under-funded plan. There are major gaps in the effort to prevent a merger, spin-off, increase in foreign ownership, or other material transactions from making a pension plan more likely to default on its pension promises:

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

Second, ERISA's definition of who is potentially liable as a plan "fiduciary" will prove meaningless in a growing number of situations where the DOL and PBGC will be unable to hold certain non-U.S. fiduciaries accountable even for knowing and willful breaches of fiduciary duty that deplete plan assets.

Third, the PBGC's authority to seek increased funding for a plan or other remedies under ERISA §4042(a)(4) is too limited, since in practice it is restricted to seeking the "nuclear option" of involuntary plan termination, which is itself a worst-case scenario for retirees. Regulators need the ability to temporarily enjoin a spin-off or other M & A activity and convince a court that a more tailored remedy, short of plan termination—such as bonds backed by tangible assets or amortizing the under-funded amount—is appropriate and practical.

Fourth, a plan sponsor's immediate liability to fund vested benefits is triggered under ERISA §4062(e) *only if* more than 20% of the *active* participants are separated from the plan, typically due to a plant closing or mass layoff. However, the PBGC has no ability to seek catch-up contributions in even worse situations, such as when a plan sponsor transfers unfunded pension liability to a weak spin-off, or retains all of the pension liability while spinning off profitable units needed to cover future contributions.

Finally, the PBGC needs to expand the transactions it scrutinizes under its Early Warning Program. The PBGC does not routinely monitor and review in advance two types of transactions that expose the agency and retirees to potentially greater risk of loss: spin-offs (whether or not pension liabilities are transferred) and acquisitions of plan sponsors by non-U.S. firms (whether in whole or in substantial part). While the greater productivity, profitability and efficiency that result from a very large percentage of corporate transactions and restructurings, it is equally important to update the rules of the road to ensure that plan sponsors and fiduciaries do not abuse gaps in the law - and in enforcement - to deny retirees and workers any part of their earned pension benefits, or to transfer a share of those losses onto taxpayers by abandoning an under-funded plan to the PBGC.

The NRLN recommends five changes for legislation, regulatory reform and stepped-up enforcement:

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

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

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

4. **Congress should expand the events that trigger immediate liability for pension under-funding pursuant to Section 4062(e), calculated on a termination basis, to include transactions that pose even greater risk to *all* plan participants.** Triggers should include spin-offs, control group break-ups and takeovers by foreign firms that transfer more than 20% of a firm's under-funded plan liabilities, or which transfer more than 20% of the plan sponsor's assets or revenues without obligation for funding plan liabilities.

5. **The PBGC should add foreign ownership, and proposed sales or spin-offs to foreign owners, along with such transactions among U.S. corporations, to the list of transactions triggering special scrutiny under the PBGC's Early Warning Program and, if possible, to the list of transactions requiring an Advance Notice of Reportable Events.**

NRLN
NATIONAL RETIREE
LEGISLATIVE NETWORK

Pension Spin-offs

Protecting Retirees from Financial Engineering and Foreign Acquisition

I. INTRODUCTION AND BACKGROUND

In 2008 financial journalist Fran Hawthorne published *Pension Dumping*, a book that chronicled how an increasing number of companies over the past decade have used bankruptcy – and the unsecured status of pension liabilities – to transfer tens of billions of dollars in legacy liabilities onto the books of the government's Pension Benefit Guarantee Corporation (PBGC), while simultaneously causing many of their retired and older workers to permanently lose billions in benefits not insured by the PBGC. She notes that pension defaults were uncommon prior to 2000. At that time defined benefit plans were over-funded an average of 20%, with $1.2 trillion in assets to cover $1 trillion in benefit obligations.[1] But after 9/11 and the recession that followed, a parade of companies in the airline, steel, auto parts and textile industries fell into bankruptcy. She writes:

> And pension promises tumbled with them. … Companies were throwing their pension plans overboard as fast as they could bail – Bethlehem Steel, LTV, Kemper Insurance, US Airways, United Airlines, Kaiser Aluminum, Polaroid . . . When Steven A. Kendarian became [PBGC] executive director in December 2001, the agency had a surplus of $10 billion . . . by the time he left a little more than two years later, it had a deficit of about $11 billion, having taken on all those abandoned pension plans.[2]

For workers, retirees and taxpayers alike, the stakes are high when an under-funded pension plan is terminated or abandoned. Despite the partial benefit guarantees provided by the PBGC's benefit insurance guarantees, when an under-funded pension plan terminates it imposes an *immediate and permanent loss of income* on many retirees and other plan participants. The permanent loss of vested but *non-guaranteed* benefits, due to various PBGC limitations, can be devastating to the individuals affected.[3]

[1] Fran Hawthorne, *Pension Dumping: The Reasons, The Wreckage, The Stakes for Wall Street*, Bloomberg Press (New York, 2008), at xvi.

[2] *Ibid*, at xvii.

[3] The four principal limitations on PBGC's guarantee of vested benefits are the maximum insurance guarantee (a maximum $54,000 at age 65), the five-year look-back excluding recent benefit increases, the "accrued at normal limitation" that discounts early retirement benefits, and the low payment priority given to any vested but non-guaranteed benefit by a participant retired (or eligible to retire) for less than three years prior to plan termination. *See* NRLN, "Pension Guarantees that Work for Retirees: A Proposal for Commonsense PBGC Reforms," White Paper, September 2010, at pp. 6-7.

The gaps in PBGC's benefit guarantees are substantial and impact a higher percentage of terminated plan participants each year. The PBGC itself reported in 2008 that ***the proportion of participants negatively impacted has tripled over the past decade.*** The share of vested benefits permanently lost has risen substantially to 28% on average per participant.[4]

For example, a 2009 study by the Government Accountability Office (GAO) identified five plan terminations that *each* resulted in more than $500 million in permanently lost benefits due to PBGC coverage limitations.[5] The largest losses occurred among the pilots and certain other airline employees at United, Delta Air Lines and U.S. Airways. At Delta, plan participants lost $2.96 billion in unfunded benefits (34.7% of their total vested but non-guaranteed benefits). At U.S. Airways, plan participants lost $1.69 billion of their vested but non-guaranteed benefits (20% of their total non-guaranteed benefits).

Preventing severe under-funding of plans – and taking action to avoid distress terminations that trigger these losses – needs to be a higher policy priority. Unfortunately, however, the PBGC and other federal regulators lack the tools to protect retirees from unnecessary – and unnecessarily severe – terminations. As section II of this paper outlines, the PBGC in particular has been increasingly aggressive about monitoring major corporate transactions and leveraging the two statutory provisions that give it some ability to negotiate with firms to reduce under-funding and/or increase guarantees (such as bonds and liens on tangible assets) that the PBGC can use to mitigate losses should the firm file for bankruptcy and terminate a substantially under-funded plan down the road. However, these tools are not nearly sufficient for the task. They are neither broad enough in scope nor flexible enough with respect to the remedies available to the agency when dealing with a severely under-funded plan.

As the Department of Labor opines in its current proposed rulemaking to update the definition of fiduciary, ERISA was written in the context of a very different economy. In the 1970s, the share of workers and retirees participating in defined benefit pension plans was still expanding. There were few apparent incentives for companies to use financial engineering to shed legacy benefit costs. Indeed, the corporate form itself was more stable, with far fewer spin-offs and split-ups of the sort of firms that maintained traditional pension plans that supported large numbers of retirees. Employers subject to ERISA were uniformly domestic, with few owned or controlled by foreign parents outside the jurisdiction of U.S. courts.

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

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

[4] "PBGC's Guarantee Limits: An Update," Pension Benefit Guarantee Corporation, September 2008.

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

First, there is an increasing trend toward corporate restructuring that has the effect, whether intentional or not, of leaving legacy pension liabilities with a substantially greater chance of ending in an under-funded distress termination. Certain corporate spin-offs, split-offs, mergers, acquisitions and takeovers have the effect of undermining the ability of the plan sponsor to support the fund long-term.

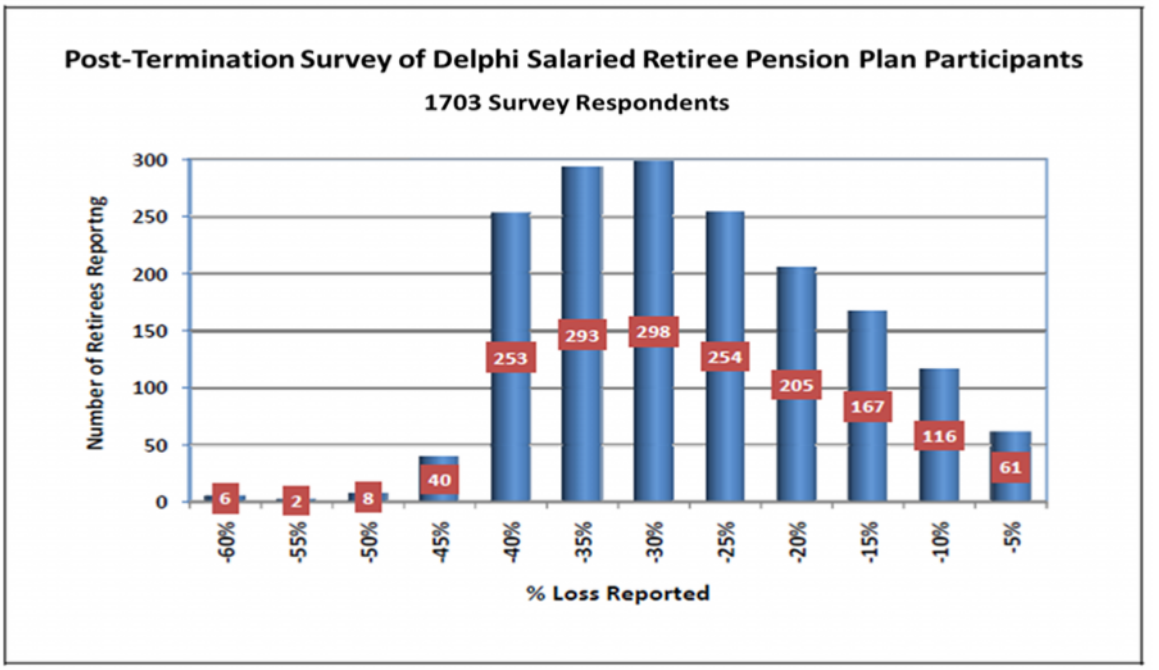
Second, and often in this same context of a material transaction or restructuring, is the steadily increasing prevalence of foreign ownership of U.S. firms with legacy pension liabilities. As explained below, while non-U.S.-based companies often improve the financial health of U.S. firms they acquire,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

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

It's clear that certain corporate transactions – particularly the spin-off of under-performing subsidiaries – are very likely to increase the long-term risk of distress termination and benefit loss for retirees transferred in the deal. Strategic spin-offs of under-performing units is a well-established tactic that holds even greater appeal when legacy pension, health and welfare benefits can be taken off the books of the parent company. As described further below, Verizon has done this twice recently by spinning off its Yellow Pages and New England rural wireline units that were both declining (due to the Internet and wireless line substitution, respectively) and dragging down the overall profit margins of a company increasingly oriented toward the fast-growing mobile phone and data business. Separated from the parent, in less than three years they both plunged into bankruptcy. Belo Corp. is another example, noted below, where the spin-off of the Texas-based media company's rapidly declining print newspaper unit (along with 60% of the company's overall pension liabilities) was a clear harbinger of a future distress termination.

The converse situation is the hollowing out of the parent company, where the pension liabilities are left behind as the more productive divisions of the original company are sold or spun off. A company can spin off its most productive and profitable division(s), leaving the legacy pension obligations (or a disproportionate share of them) behind in a likely-to-fail shell company. A potential example of this was evident in the PBGC's intervention late last year when Motorola announced that it would spin off its consumer mobile handset business into a new company ("Motorola Mobility"), but leave all pension liabilities with the original company ("Motorola Solutions"), which would have less revenue to support contributions to the already-under-funded plan. In this case the PBGC was able to leverage its "nuclear option" to threaten court approval to terminate the plan under ERISA Section 4042(a) – which would impose immediate liability for under-funding – to obtain Motorola's agreement to contribute an additional $100 million to the plan. However, the agency will be able to tailor remedies to protect retirees in a wider range of such transactions if Congress amends Section 4042(a) as recommended in section IV below.

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



(with some losing more than 40%).[6] Delphi evolved as part of GM until it was spun off as a separate entity in 1999. By 2005, the company employed more than 185,000 workers in 38 countries, making it one of the largest suppliers in the world. However, on October 8, 2005, Delphi Corporation and its U.S. subsidiaries filed for Chapter 11 bankruptcy protection. Four years later, the PBGC terminated all six of Delphi's U.S. defined-benefit plans and most of Delphi's U.S. and foreign operations were sold to a new entity, known as "New Delphi," in October 2009.[7] A survey of Delphi plan participants with 1,700 respondents reported the following reductions in vested benefits paid by the PBGC:[8]

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

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

As globalization and the acquisition of American companies by foreign firms and investors becomes increasingly common, there is a particular concern about the PBGC's ability to deter plan terminations by, or recover assets from, foreign-owned or foreign-based plan sponsors. As a legal matter, ERISA

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

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

[8] Delphi Salaried Retirees' Association, 2010 Survey of 6,700 participants in the Delphi Retirement Program for Salaried Employees. Significantly, 73% of the 1,703 respondents were under the age of 65 at the time of plan termination, with 44% between age 60 and 64. The PBGC's maximum benefit guarantee – $54,000 for a retiree who is age 65 at plan termination – is reduced substantially for each year under age 65 at the time of termination.

makes no distinction between U.S. and foreign-based companies with respect to a plan sponsor's funding obligations, fiduciary duty and potential liability for vested benefits. Every member of an employer's "controlled group" is jointly and severally liable for pension underfunding in the case of a distress termination. However, as a practical matter, the PBGC has had great difficulty persuading either U.S. or foreign courts to attach or to enforce a lien against the assets of a plan sponsor outside the territorial jurisdiction of the U.S. Actually collecting on a liability in practice requires that the foreign entities have sufficient assets within the jurisdiction of U.S. courts. As a result, the steadily increasing number of pension plans acquired by non-U.S. firms not subject to the jurisdiction of U.S. courts – and the growing number of foreign fiduciaries – requires new tools for regulators since it widens the gap in protections for retirees and other plan participants even further.

An increased volume of acquisitions and takeovers of U.S. firms and spin-offs by foreign buyers is both a two-decade trend and viewed by most experts as inevitable in a global economy where capital flows more freely and geographic borders matter less than the strengths and weaknesses of increasingly multinational companies. There is little question that the share of foreign-based multinationals and investors, including foreign governments, acquiring U.S. companies with substantial pension liabilities is steadily rising. U.S. Commerce Department data shows that in 2008, foreign firms spent $252 billion in acquisitions of existing U.S. firms, which represented 93% of total new direct foreign investment in the U.S. that year.[9] This demonstrates incredible growth considering that total new foreign direct investment in the U.S. only exceeded $100 billion for the first time in 1998. Cumulative foreign direct investment rose from about $2.2 trillion in 2008 to $2.3 trillion in 2009 and is no doubt considerably higher today because a cheaper U.S. dollar discounts the cost of U.S. assets from the perspective of many prospective foreign purchasers.[10]

At year-end 2007, foreign firms owned 36,000 U.S. business establishments and employed more than 6 million Americans.[11] Nearly 40% of the workers employed by foreign-owned firms are in the manufacturing sector – more than twice the share of manufacturing employment in the economy as a whole. Manufacturing firms pay higher wages and are far more likely to maintain legacy pension, health and welfare benefit plans. Pension coverage is also much more prevalent at very large U.S. firms. And according to the Congressional Research Service, "[t]he average plant size for foreign-owned firms is much larger – five times – than for U.S. firms, on average, in similar industries."[12]

Foreign takeovers also increasingly target large, well-established companies that are more likely to have defined-benefit pension arrangements. For example, during the second half of 2009, the 10 largest M&A deals in the U.S. involved foreign companies acquiring American firms, according to data from Thomson Financial. This has occurred most prominently in the auto sector, where Germany's Daimler acquired Chrysler which, a few years later (thanks to the U.S. and Canadian government's controlled bankruptcy process), ended up under the majority control of Italy's Fiat.

While many foreign buyers increase investment in their U.S. subsidiaries, others take over U.S. firms to gain access to U.S. markets, or to U.S. technology, and reduce investment, employment and retirement security overall. As a multiple of company revenue and capitalization, perhaps the largest pension transfer in recent history was the 2006 acquisition of Lucent Technologies by the French telecom

---

[9] James K. Jackson, "Foreign Direct Investment in the United States: An Economic Analysis," Congressional Research Service, July 28, 2010, at p. 4.

[10] *Ibid*, at p. 1.

[11] U.S. Department of Commerce, Bureau of Economy Analysis, "Foreign Direct Investment in the United States: Operations of U.S. Affiliates of Foreign Companies, Preliminary 2007 Estimates," Table 1A-1 (2009).

[12] James K. Jackson, "Foreign Direct Investment in the United States: An Economic Analysis," Congressional Research Service, July 28, 2010, at p. 5.

equipment maker Alcatel. The merged Alcatel-Lucent, based in Paris, immediately cut thousands of U.S. jobs. Since retirees now represent the overwhelming majority of the participants in pension plans of the struggling Alcatel-Lucent USA subsidiary, they are now rightly concerned about whether the Paris-based firm will honor the company's pension promises – and, if it does not, whether U.S. regulators have the tools and authority to enforce the liabilities and keep retirees whole.

II. EXISTING TOOLS ARE TOO LIMITED TO PROTECT RETIREES

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

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

At present, the government's primary authority to protect retirees and other plan participants in the aftermath of a corporate spin-off or other M&A transaction is the PBGC's ability to initiate an involuntary plan termination. Under ERISA § 4042(a)(4), the PBGC "may institute proceedings . . . to terminate a plan whenever it determines that the possible long-run loss of the corporation with respect to the plan may reasonably be expected to increase unreasonably if the plan is not terminated."

Although the PBGC has no authority to block a spin-off or other transaction, the agency can threaten to seek the permission of a U.S. District Court to institute an involuntary termination. Because the company would be immediately liable for the present value of all vested benefits calculated using the very low discount rate that the PBGC uses to calculate termination liability, a credible threat from the PBGC could scuttle the transaction.[13] Even if the PBGC is not likely to prevail in court, its public statements questioning the pension impact of the transaction and raising the possibility of termination liability can become an obstacle to the company's transaction. As a result, in a number of cases the agency has been able to extract concessions that seek to shore up underfunding or otherwise protect the PBGC from larger losses if the plan terminates at a later date.

Although the PBGC does not frequently wield the threat of involuntary termination to extract funding concessions, the agency has leveraged this authority more often over the past couple years. The following recent examples are illustrative:

Motorola Spin-Off: Late last year Motorola announced it would spin off Motorola Mobility, its division that primarily makes smartphones and other mobile consumer devices. The company's remaining business, renamed Motorola Solutions, would retain all of the legacy pension plan liabilities. As a result,

[13] When an underfunded pension plan is terminated, the PBGC has a claim against the plan sponsor and each member of its controlled group equal to the entire amount of underfunded benefit liabilities. The PBGC chooses to estimate a plan sponsor's "termination liability" using a discount rate derived from the price that commercial insurance companies charge for fixed and deferred annuities. This discount rate is substantially lower than the AA corporate bond yield curve that plan sponsors are required to use to estimate and report their liabilities and minimum funding requirements. Because the PBGC assumes a much lower discount rate on future benefit obligations (currently under 5%), even a plan considered to be fully funded on an ongoing basis will be roughly 30% underfunded on a termination basis, which is potentially an enormous liability. *See* National Retirees Legislative Network, *Pension Guarantees that Work for Retirees: A Proposal for Commonsense PBGC Reforms*, White Paper (September, 2010).

the future growth and revenue from the mobile phone portion of the business would no longer contribute to the pension plan, which has 87,000 participants, the majority of them retirees. On January 4, 2011 the PBGC announced that Motorola Solutions had agreed to contribute an additional $100 million to the Motorola Pension Plan over the next five years above and beyond legal requirements.[14]

***A.H. Belo Spin-Off*:** Belo Corp., a Dallas-based broadcasting company, spun off its declining newspaper business in 2008, creating A.H. Belo as a separate company (and a pure newspaper play). Last October, 2010, the companies agreed to transfer roughly 60% of the assets and liabilities of the Belo pension plan to the financially weaker A.H. Belo spin-off. The PBGC questioned the transaction, particularly with respect to the ongoing funding level of the new A.H. Belo plan, which would now be supported entirely by a declining newspaper business (and not by the more profitable local television station chain that remained with the parent). In March 2011 the two companies signed an agreement with the PBGC requiring an additional $30 million payment to the new A.H. Belo plan above and beyond contributions required by ERISA.[15] The PBGC also reserved its right to come back at the previous plan sponsor (the more profitable Belo) if A.H. Belo declares bankruptcy or otherwise defaults.[16]

Canadian Group LBO of Tomkins: In July 2010, Onex Corp., a Canadian holding company, and the Canada Pension Plan Investment Board announced a leveraged-buyout of Tomkins, a U.S.-based manufacturer of auto parts and building materials.[17] Since Tomkins' 10 U.S. plans were underfunded by more than $200 million, the PBGC sought to make at least a reduction of the company's underfunded status a condition of the sale. Under the agreement, the new buyers agreed that Tomkins will contribute an additional $5 million to its largest pension plan and forgo an option to delay $35 million in contributions under funding relief legislation enacted in 2010.[18]

AIG's Sale of American General Finance: The PBGC negotiated $4 million in additional pension payments by the American International Group (AIG) after it reviewed the sale and transfer of pension liabilities of the failing firm's American General Finance subsidiary. Under the Early Warning Program, the PBGC reviewed a number of AIG divestitures to determine whether it could jeopardize the pension plans sponsored by AIG. "One way PBGC protects pensions is to work with companies *before* they undertake major transactions," said PBGC Director Josh Gotbaum. "AIG's actions demonstrate its commitment to its employees and retirees."[19]

Daimler Sale of Chrysler: While these three most recent examples involved relatively small payments, the PBGC has intervened in a few other situations impacting substantial numbers of retirees and other plan participants. One of the largest involved the sale of a controlling interest in Chrysler by foreign automaker Daimler, which is based in Germany, to Cerberus, a U.S.-based hedge fund. In 2007 DaimlerChrysler agreed to a $1 billion termination guarantee negotiated by the PBGC. In August 2009, when Daimler sought to transfer its remaining 20% ownership stake, the PBGC negotiated additional cash

---

[14] *See* PBGC News Release, "PBGC, Motorola Agree on $100 Million in Pension Protection" (Jan. 4, 2011).

[15] Timothy Inklebarger, "Belo DB Pension Plans Split," *Pensions & Investments*, Jan. 4, 2011, available at http://www.pionline.com/article/20110104/DAILYREG/110109981#ixzz1ORmP47Gw.

[16] Agreement between A.H. Belo, Belo Corp. and PBGC, Exhibit 10.3.6, A.H. Belo Annual Report on Form 10-K (March 11, 2011), available at http://investor.ahbelo.com/phoenix.zhtml?c=219524&p=irol-sec.

[17] Marketwire, "Onex and CPPIB Complete US$5.0 Billion Acquisition of Tomkins," Sept. 30, 2010, available at http://www.marketwire.com/press-release/onex-and-cppib-complete-us50-billion-acquisition-of-tomkins-plc-tsx-ocx-1327431.htm.

[18] John Kell, "PBGC Negotiates $44 Million in Funding for Tomkins Pension Plans," *Dow Jones Newswires*, October 28, 2010, available at http://www.automatedtrader.net/real-time-dow-jones/26623/pbgc-negotiates-44-million-in-funding-for-tomkins-pension-plans.

[19] *See* PBGC News Release, "PBGC, AIG Agree on Pension Protection in Fortress Sale" (Feb. 3, 2011).

contributions by Daimler and an extension of the guarantee (in case Chrysler's plan terminated). E.F. Millard, then interim PBGC director, announced that the Chrysler "pension plans will receive an infusion of $200 million in extra contributions, and Daimler will provide a $1 billion guarantee for up to five years."[20] Ironically, it was another foreign automaker, Italy's Fiat, that stepped up to purchase the bulk of the assets of Chrysler LLC in 2009 through a new corporate entity whose equity is owned by a group that includes Fiat Corp., the United Auto Workers, and the U.S. and Canadian governments.[21] The controlled bankruptcy preserved the pension plans. Fiat acquired a majority interest in June 2011.

Despite these successes, the PBGC itself considers its authority under Section 4042(a)(4) a "nuclear option" that is of limited utility for preventing a spin-off or other material transaction from undermining the long-term solvency of a pension plan. This is true for a number of reasons that are described in the next section below. Foremost among them is that unlike bank and other financial regulators, the PBGC's only available remedy is to kill the patient. The agency's threat is premised on acquiring a federal district judge's approval to allow, over the company's objections, an involuntary termination that imposes permanent losses on many younger retirees and older workers, as well as on taxpayers by adding to the PBGC's mounting deficit. The NRLN believes ERISA should give regulators a greater ability to temporarily enjoin a spin-off or other M & A activity and convince a court that a more tailored remedy, short of plan termination, is appropriate and practical.

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

The other principal statutory provision that can be leveraged to reduce pension underfunding and protect at least some plan participants in the context of a corporate restructuring is ERISA Section 4062(e), which is triggered by a "substantial cessation of operations." If an employer closes a facility and, as a result, "more than 20% of the total number of his employees who are participants under a plan … are separated from employment,"[22] the employer becomes immediately liable for that same percentage of the plan's total unfunded liability calculated on a termination basis.[23] As noted above, since PBGC's calculation of termination liability is greatly inflated compared to the funding levels an ongoing pension plan reports to participants under ERISA's rules, immediate liability for even 25% or 35% of the total termination liability is a burden companies are often motivated to negotiate and resolve.[24]

The PBGC's General Counsel told the American Bar Association last fall that the agency has "stepped up [its] activity in this area in the last few years and it has become an important part of [PBGC's] risk

---

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

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

[22] ERISA § 4062(e); 29 Code of Federal Regulations (PBGC Regulations) § 4062.8, ¶ 15,621G.

[23] In August, 2010 the PBGC released a proposed rule that would clarify that the liability is triggered by the 20% threshold irrespective of any assessment of an assessment of the firm's financial health, as well as provide fewer exemptions and more stringent reporting requirements. *See* Federal Register, Proposed Rule, "Liability for Termination of Single-Employer Plans - Treatment of Substantial Cessation of Operations," RIN 1212-AB20, Vol. 75, No. 153 (August 10, 2010), at p. 48283; available at http://www.gpo.gov/fdsys/pkg/FR-2010-08-10/pdf/2010-19627.pdf#page=1.

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

mitigation program."[25] Since 2007 the PBGC has used the cessation of operations provision to extract more than $750 million in additional contributions or guarantees from plan sponsors for defined benefit plans covering more than 80,000 workers and retirees.[26] In testimony to the Senate last December, 2010, PBGC Executive Director Josh Gotbaum highlighted the use of this authority as a tool the agency is using more aggressively in an effort to avoid taking over the plans of troubled companies:

> Under the Early Warning Program, PBGC monitored more than 1,000 companies to identify transactions that could threaten a company's ability to pay pensions, and negotiated protections for the plans. When major layoffs or plant closures threaten a plan's viability, PBGC can step in and negotiate protection for the pension plan, including a guarantee, posting of collateral or contributions to the plan. In this way, last year PBGC secured an additional $250 million for participants in 20 pension plans. When companies do enter bankruptcy, we encourage them to keep their plans intact.[27]

Of course, if the firm is also declaring bankruptcy and eligible for a distress termination, this provision is largely moot. However, where the company weathers the downsizing and continues on, the PBGC has been able to negotiate significant additional contributions, including from foreign-controlled companies that otherwise might not be subject to court-imposed liens against their remaining U.S. assets.[28] Where plan sponsors credibly demonstrate that immediate cash payment of the liability is impractical or could disrupt the company, the PBGC has negotiated agreements to amortize payments and/or accept a mechanism (such as an escrow account or collateralized bond) to guarantee payment. Some notable examples over the past few years include:

Electrolux (2007): After Swedish-owned Electrolux Home Products Inc. shut down its plant in Greenville, Michigan in 2006, the PBGC reached a $77.5 million agreement to shore up funding for the benefits of more than 2,350 former employees. The settlement aimed to bring the company's under-funded plans up to full funding over a five-year period. PBGC Interim Director Charles E.F. Millard stated at the time that "[t]he PBGC will continue to aggressively monitor business transactions that may jeopardize pension plans and arrange suitable protections, as we have done with Electrolux and earlier this year with Cerberus/DaimlerChrysler."[29]

Elkem (2008): In July 2008 the PBGC announced an agreement with Norwegian-owned Elkem Metals Inc. that promised to boost funding for the pension plan of 1,600 workers and retirees by $17.3 million and to guarantee another $22 million if the PBGC later takes over the plan. Approximately 80% of

---

[25] Presentation of PBGC General Counsel Israel Goldberg, American Bar Association, Section on Taxation, 2010 Joint Fall CLE Meeting, available on audio tape at http://www.dcprovidersonline.com/abatx/index.php#add.

[26] According to the PBGC's 2010 Annual Report, "[d]uring FY 2010, PBGC opened 129 new 4062(e) cases, as compared with 105 in 2009 and 40 in 2008, and reached settlements with 20 companies for approximately $250 million." PBGC, 2010 Annual Report, at p. 9, available at http://www.pbgc.gov/docs/2010_annual_report.pdf.

[27] Statement of Joshua Gotbaum, Director, Pension Benefit Guaranty Corporation before the Senate Committee on Health, Education, Labor, & Pensions, Dec. 1, 2010, available at http://www.pbgc.gov/news/testimony/page/tm122010.html.

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

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

Elkem's active participants were separated from the plan when the company sold plants in Oklahoma and West Virginia to buyers who would not agree to assume the liabilities of the company's retirement plan.[30]

Visteon (2009): After Ford Motor Company spun off its auto parts subsidiary, Visteon, it soon began downsizing through plant closings on its path toward an eventual May 2009 bankruptcy filing. Along the way, the separation of 5,300 workers at two Indiana plants triggered the company's liability under ERISA Section 4062(e). In January 2009, prior to the bankruptcy, the PBGC announced a negotiated agreement with Visteon and Ford to contribute an additional $55 million to shore up its under-funded plans.[31] After it filed for bankruptcy, with unfunded liabilities of nearly $900 million, Visteon sought to terminate three of its four plans, a "move that would have caused $100 million in benefit reductions for the company's 22,000 workers and retirees."[32] The PBGC renegotiated the agreement to keep the plans operating, which also avoided $500 million in additional liabilities for PBGC.

Borg Warner (2010): After Borg Warner shuttered its Muncie, Indiana auto transmission parts plant, laying off more than 3,000 active plan participants, the PBGC negotiated $111 million in additional contributions over a four-year period.[33]

The partial termination liability triggered by major plant closings or mass lay-offs under ERISA Section 4062(e) allows the PBGC to shore up the funding of impacted plans to some degree. However, while useful, the narrow 20% force reduction requirement fails to trigger liability for under-funding by a range of other transactions that often pose even greater risk to *all* plan participants, the vast majority of which are often retirees and not active workers. These include not merely substantial downsizings, but also spin-offs, control group break-ups and takeovers by foreign-owned firms largely beyond the reach of the PBGC and ERISA fiduciary enforcement. This gap in Section 4062(e)'s ability to protect retirees is described further in the next section.

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

Although rarely used, one additional statutory tool available to the PBGC is ERISA section 4069, which imposes termination liability retrospectively on a contributing plan sponsor if it can be shown that "a principal purpose" of "any transaction is to evade liability" and the transaction that results in a distress termination "becomes effective within five years before the termination date" of the plan.[34] Among the corporate transactions referenced in the statute are mergers, consolidations or divisions, as well "liquidation into a parent corporation."[35]

An example could be the strategic spin-off of the growing, more profitable portions of a business into a new company, while leaving the under-funded legacy obligations for retiree benefits in a hollowed-out parental shell. Motorola's division into two independent firms at the end of 2010 – with one (Motorola Mobility) free of any defined-benefit pension liabilities – could arguably trigger this provision if the

[30] "PBGC Negotiates Deal to Strengthen Pension Funding at Elkem Metals Inc.," PBGC News Release No. 8-40, July 24, 2008.
[31] "PBGC Negotiates $55 Million in Pension Protection with Visteon Corp.," PBGC News Release No. 09-11, January 05, 2009.
[32] "Statement of PBGC Director Joshua Gotbaum on Visteon Plan of Reorganization," PBGC News Release No. 10-49, August 31, 2010. *See also* Timothy Inklebarger, "Visteon Plans Underfunded by $893 Million," *Pensions & Investments*, May 28, 2009, available at http://www.pionline.com/article/20090528/DAILYREG/905289980.
[33] "PBGC Negotiates $111 Million of Additional Pension Protection for Indiana Workers at BorgWarner," PBGC News Release No. 10-26, March 24, 2010, available at http://www.pbgc.gov/news/press/releases/pr10-26.html.
[34] ERISA § 4069(a).
[35] ERISA § 4069(b).

legacy half of the company becomes bankrupt and defaults on its pension obligations (which are overwhelmingly to retirees, not actives) within five years. However, as the company's modest settlement with the PBGC under section 4042(a)(3) indicates (described above), there are so many other business reasons for such a transaction that it could be extremely difficult to convince a court that "a principal purpose" of the spin-off (rather than a mere inadvertent outcome) was to evade pension liability by making it more likely they would be assumed by the PBGC when the crippled parent finally failed.

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

The PBGC's Early Warning Program (EWP) monitors financially weak companies and corporate transactions that appear to pose a risk of long-run loss to the pension insurance program.[36] The EWP generally receives high marks for monitoring companies with significant underfunding. It currently monitors 1100 companies with more than $50 million in underfunding. It also screens for and monitors companies with below-investment-grade bond ratings and underfunding in excess of $5 million. In addition, the PBGC monitors notifications of a wide range of "reportable events," the most potentially significant of which (e.g., pension liability transfers, liquidations, bankruptcy, loan defaults, or change in contributing plan sponsor) require non-public companies to file notification of the transaction with the PBGC at least 30 days in advance of the closing date.

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

> Reportable events often signal financial distress and possible plan termination. When PBGC has timely information about a reportable event, it can take steps to encourage plan continuation—for example, by exploring alternative funding options with the plan sponsor—or, if plan termination is called for, to minimize the plan's potential funding shortfall . . . . Without such timely information, PBGC typically learns that a plan is in danger only when most opportunities for protecting participants and the pension insurance system may have been lost.[37]

The EWP is not mandated by ERISA, but created and recently expanded at the PBGC's initiative under its authority to initiate a preemptive plan termination under Section 4042.[38] Although the PBGC has no authority to veto a transaction, it can and has extracted concessions that seek to shore up underfunding or protect the PBGC's position as part of the transaction. Under this authority, the PBGC has leverage because it can threaten a company with involuntary termination, as described above. It can also make public statements that result in negative media coverage and potentially weaken the company's position.

According to PBGC staff managing the EWP, the agency is particularly on the lookout for material transactions (including spin-offs, LBOs, extraordinary dividends, asset divestitures) that could down the

---

[36] *See* PBGC, "Technical Update 00-3: PBGC's Early Warning Program," July 24, 2000 (updated Jan. 4, 2008), available at http://www.pbgc.gov/practitioners/law-regulations-informal-guidance/content/tu12795.html.

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

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

road make an already-underfunded plan much more vulnerable to a distress termination. The staff emphasizes that by using two different screens (one based on reportable transactions, irrespective of underfunding; the other based on underfunding and deterioration of credit agency bond ratings) they believe that they are monitoring most companies with a heightened risk of termination. The list of Advance and Post-Event reportable transactions are in a box below.

The following are examples of events that plan sponsors must report to the PBGC, although there are complex waivers that create exemptions in many cases:[39]

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

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

• **Transfer of Plan Liabilities**. The plan transfers 3% or more of its liabilities to a plan or plans maintained outside of the controlled group. Notice is waived if (i) there is a transfer of all of the plan's assets and liabilities, (ii) the transfer complies with Section 414(l) of the Internal Revenue Code, but using the actuarial assumptions specified by the PBGC, or (iii) both the plans are fully funded after the transfer, using PBGC actuarial assumptions.

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

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

Part 4043 - Reportable events and certain other notification requirements

Subpart B--Post-Event Notice of Reportable Events

4043.20 Post-event filing obligation.
4043.21 Tax disqualification and Title I noncompliance.
4043.22 Amendment decreasing benefits payable.
4043.23 Active participant reduction.
4043.24 Termination or partial termination.
4043.25 Failure to make required minimum funding payment.
4043.26 Inability to pay benefits when due.
4043.27 Distribution to a substantial owner.
4043.28 Plan merger, consolidation, or transfer.
4043.29 Change in contributing sponsor or controlled group.
4043.30 Liquidation.

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

4043.31 Extraordinary dividend or stock redemption.
4043.32 Transfer of benefit liabilities.
4043.33 Application for minimum funding waiver.
4043.34 Loan default.
4043.35 Bankruptcy or similar settlement.

Subpart C--Advance Notice of Reportable Events

§ 4043.61 Advance reporting filing obligation.

(a) **In general.** Unless a waiver or extension applies with respect to the plan, each contributing sponsor of a plan for which a reportable event under this subpart is going to occur is required to notify the PBGC no later than 30 days before the effective date of the reportable event ….

4043.61 Advance reporting filing obligation.
4043.62 Change in contributing sponsor or controlled group.
4043.63 Liquidation.
4043.64 Extraordinary dividend or stock redemption.
4043.65 Transfer of benefit liabilities.
4043.66 Application for minimum funding waiver.
4043.67 Loan default.
4043.68 Bankruptcy or similar settlement.

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

As noted above, the PBGC has the authority under ERISA section 4042(a) to review a spin-off to determine whether the transaction "unreasonably" increases the risk of long-run loss to the pension insurance system. In addition, Section 414(l) of the Internal Revenue Code provides, in part, that each plan participant must be eligible to receive a benefit immediately after any merger or spin-off that is equal to or greater than the benefit he would have been entitled to receive immediately before the transaction. If some portion of a qualified plan's liabilities is transferred in a corporate spin-off or other sale, it must be funded by a proportional allocation of plan assets.[40] If the transferred liabilities are not fully funded using the PBGC assumptions for calculating termination liability, a reportable event filing must be made to the PBGC including an explanation of the assumptions used.[41]

Internal Revenue Code Section 414(l)'s provisions regarding the allocation of assets in a plan spin-off are enforced by the IRS and are not reviewed by PBGC. Section 414(l) is intended to prevent a plan sponsor from using a spin-off or transfer to either cut vested benefits for a group of participants or to reduce the proportion of assets available to pay for them. In practice, however, this provision is narrow in scope and protects retirees only in a small subset of corporate transactions. Section 414(l) exempts "spin-offs" that

[40] Internal Revenue Code § 414(l). In this context, the term "spinoff" means the splitting of a single plan into two or more plans. Treas. Reg. 1.414(l)-1(b)(4). IRC § 6058(b) requires plan administrators to file a report with the IRS not less than 30 days before a merger, consolidation or transfer of assets or liabilities from one plan to another.

[41] *See* 29 Code of Federal Regulations § 4043.32. Although the PBGC's methodology for estimating termination liability is a safe harbor, more commonly the actuary for the transferring plan can certify that the assumptions used are reasonable.

involve the transfer of the entire plan to a new controlled group.[42] It also exempts situations where the acquiring firm terminates the pension plan as part of the transaction.[43]

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

As the section above explains, ERISA provides a patchwork of weak protections against certain spin-offs, mergers, foreign acquisition, plant shutdown or other financial engineering that obviously undermine the likelihood that a pension plan will be able to meet its benefit obligations – and not default to the PBGC. Although traditional pension benefits are insured by PBGC, an insolvent or abandoned pension plan inevitably means that many retirees and older workers lose a substantial portion of their promised retirement income. Recall that even among retirees receiving a monthly pension benefit below the maximum amount insured by PBGC, the benefits actually paid by the agency are typically much lower than the vested benefits earned by a substantial share of participants. While the majority of retirees are not impacted by the PBGC's guarantee limits, a 2008 study by the PBGC showed that the proportion of participants negatively impacted has *tripled* over the past decade. Because of a variety of PBGC practices, the share of vested benefits permanently lost has risen substantially to 28% on average per participant.[44]

The single largest legal gap in the protection for retiree benefits is the status of pension liabilities in bankruptcy proceedings. While this paper focuses on corporate M&A activity that does *not* involve bankruptcy (although recognizing that some of these transactions pave the road to a bankruptcy and pension default years later), the NRLN highlighted this problem in a 2009 white paper.[45] Despite the fact that Congress legislated special procedural and substantive protections for retiree benefits in bankruptcy, particularly through the retiree committee provided for under section 1114 of the Bankruptcy Code, recent high-profile corporate bankruptcy cases have highlighted (and in some cases created) the loopholes that result in pension liabilities receiving a low priority for payment.

Over the past decade the number the number of employers terminating underfunded plans after seeking protection under Chapter 11 of the Bankruptcy Code has increased dramatically. As one law review article summed it up, pension under-funding is encouraged by "the dysfunctional relationship between the Tax Code, ERISA, and the Bankruptcy Code, which places the PBGC at a disadvantage when employers terminate their pension plans after filing bankruptcy."[46] Since bankruptcy courts view their highest priority as engineering a solution that reduces a company's costs so that it can emerge from bankruptcy, judges are inclined to agree to a company's request to terminate the "legacy" costs of promised pension, health and welfare benefits.[47] "When a pension plan is terminated after the employer has filed bankruptcy, certain portions of the Bankruptcy Code strip employees and the PBGC of the protections created under ERISA."[48] The PBGC lien against the company's remaining assets cannot arise until *after*

[42] I.R.C. § 414(l)(2)(D)(ii) provides that the general protection described in § 414(l) does not apply "if, after such spin-off, such plan is maintained by an employer who is not a member of the same controlled group as the employer maintaining the original plan."
[43] I.R.C. § 414(l)(2)(D)(iv).
[44] "PBGC's Guarantee Limits: An Update," Pension Benefit Guarantee Corporation, September 2008. *See also* NRLN, "Pension Guarantees that Work for Retirees," White Paper, September 2010, at pp. 7-10.
[45] NRLN, "Proposal for Bankruptcy Law Reform: Protecting Retiree Benefits in Bankruptcy," September 9, 2009.
[46] Nicholas J. Brannick, "At the Crossroads of Three Codes: How Employers are Using ERISA, the Tax Code, and Bankruptcy to Evade Their Pension Obligations," 65 *Ohio State Law Journal* 1577 (2004).
[47] *See generally* Fran Hawthorne, *Pension Dumping*, Bloomberg Press (New York, 2008).
[48] *Ibid*, at p. 1601.

plan termination; but, paradoxically, plan termination after a Chapter 11 bankruptcy filing prevents the perfection of the PBGC's lien.[49]

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

First, the PBGC (and retirees) have a very limited ability to either attach or enforce a lien against the tangible assets of a contributing sponsor or other named fiduciary located outside the jurisdiction of the U.S. federal courts. It is not even clear that the PBGC can perfect a lien against other U.S.-based assets or subsidiaries of a foreign company that are not part of the plan's controlled group. ERISA's otherwise strict standard of accountability is negated if a foreign firm or individual can act as a fiduciary with respect to the administration or control of plan assets while remaining immune from the judgment of a U.S. court.

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

Third, the PBGC's authority to seek increased funding or other remedies under ERISA section 4042(a)(4) is too limited, since in practice it is restricted to seeking the "nuclear option" of involuntary plan termination, which is itself a worst-case scenario for retirees. Regulators need the ability to temporarily enjoin a spin-off or other M & A activity and convince a court that a more tailored remedy, short of plan termination, is appropriate and practical. Although the agency today is able in some cases to negotiate additional contributions, bonds or other guarantees against a default on unfunded liabilities, in too many others it is powerless to protect either plan participants or taxpayers against abusive transactions.

Fourth, a plan sponsor's immediate liability to fund vested benefits is triggered under ERISA section 4062(e) *only if* more than 20% of the *active* plan participants are separated from the plan, most commonly due to a plant closing or mass layoff. However, the PBGC has no similar ability to seek funding in similar or potentially worse situations, such as when a plan sponsor transfers a substantial pension liability to weak spin-off, or retains all of the pension liability while spinning off very valuable and profitable portions of the company needed to cover future contributions.

Finally, the PBGC needs to expand the number of transactions it scrutinizes under its Early Warning Program. The agency currently monitors roughly 1,100 companies with more than $50 million in underfunding, or which have below-investment grade bond ratings and under-funding in excess of $5 million. In addition, the PBGC monitors notifications of a wide range of "reportable events" (see above), some of which are provided in advance, although these are required from public companies only 30 days *after* a transaction. However, it does not appear that the PBGC routinely monitors and reviews in advance two types of transactions that expose the agency and retirees to potentially greater risk of loss: spin-offs

[49] *Id.,* at p. 1606-1610.

(whether or not pension liabilities are transferred) and acquisitions of plan sponsors by non-U.S. firms (whether in whole or in substantial part).

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

As globalization and the acquisition of American companies by foreign firms and investors becomes increasingly common, there is growing concern about the PBGC's ability to deter plan terminations by, or recover assets from, foreign-owned or foreign-based plan sponsors. As a legal matter, ERISA makes no distinction between U.S. and foreign-based companies with respect to a plan sponsor's funding obligations, fiduciary duty and potential liability for vested benefits. The foreign-based parent of a U.S. subsidiary that is a contributing plan sponsor is part of a plan's "controlled group" and subject to precisely the same obligations and scrutiny as U.S.-based companies (including the reportable events rules and Early Warning Program monitoring described just below).[50] Every member of an employer's "controlled group" is jointly and severally liable for pension underfunding in the case of a distress termination.

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

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

To date, the PBGC has not fared well in the courts. Before the PBGC (or plan participant) can even seek to enforce a judgment, it must first convince a U.S. court that it has personal jurisdiction over the foreign parent or other allegedly liable foreign fiduciary. In *GCIU-Employer Retirement Fund v. Goldfarb Corp.*, the Seventh Circuit Court of Appeals rejected the PBGC's attempt to proceed in federal court to collect withdrawal liability against the Canadian parent (Goldfarb) of a U.S. subsidiary.[51] The Court ruled that the foreign parent did not have sufficient contacts with the U.S. to confer personal jurisdiction on a U.S. court. The court emphasized that Goldfarb was based in Canada and did not maintain a place of business, employ individuals, serve customers, or have a designated agent for service of process inside the U.S.

To its credit, the PBGC has recently become more aggressive in pursuing claims against the foreign parent of U.S. subsidiaries that walk away from their underfunded pension obligations. In November, 2010, the PBGC filed a $175 million claim against Asahi, the Japanese parent of Metaldyne, a wholly-

[50] A company's "controlled group" includes its subsidiaries, parent, and other subsidiaries of the parent, provided that an 80% ownership test is satisfied. For a definition of "controlled group." *See* 26 U.S.C. § 1563 (2009).

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

owned U.S. subsidiary that terminated a substantially under-funded plan.[52] The PBGC's claim states that as part of the plan sponsor's controlled group, Asahi is jointly liable for the total underfunding related to the termination of the Metaldyne pension plan, as well as the PBGC's litigation costs in connection with recovery of those liabilities. Once again, a U.S. court can only adjudicate pension-related claims against a foreign company like Asahi if it has personal jurisdiction because of the company's activities in the U.S. As one leading U.S. law firm stated, "if a foreign defendant does not have sufficient contacts with the United States, the case will be dismissed. Meeting this requirement is one of the key impediments to any PBGC claim in a US court against a foreign member of a controlled group."[53]

The PBGC indicates that the problem of collecting from the bankrupt U.S. subsidiary of a larger foreign parent is coming up more frequently. For example, over the past year the agency reported on its thus-far futile attempts to collect the termination liability from several under-funded subsidiaries of foreign-based firms. Last year the PBGC announced that Bendix, an auto systems manufacturer and wholly-owned subsidiary of a German company (Knorr-Bremse AG), had essentially refused to pay the termination liability associated with its shutdown of a brake compressor plant in Kentucky (which it moved to Mexico).[54] If Bendix and/or its parent do not have substantial U.S.-based assets, the PBGC and the company's workers and retirees may suffer a permanent loss. Similarly, in March 2011, the PBGC initiated an involuntary termination of the pension plan at another German-owned U.S. affiliate because the parent company (Bowe Systec, AG) is liquidating and the U.S. plan is only 50% funded.[55]

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

Even if the PBGC or a plan participant prevails on these jurisdictional issues and wins a monetary judgment in U.S. federal court, enforcing it in a foreign court faces high hurdles. As an agency of the U.S. government, the PBGC in particular faces a number of roadblocks to collecting on an ERISA claim in a foreign court. "For example, the success of a claim in a foreign court could hinge on such court's recognition of US laws (under principles including Comity, which is the acceptance of laws of a court of another jurisdiction), and related exceptions, *e.g.*, "revenue rule," the "public law" exception, tax treaties, etc.) and, further, the US and foreign courts' analyses of the extraterritorial reach of ERISA."[56]

The PBGC takes the position, correctly, that all members of a controlled group, including subsidiaries located completely outside the U.S., are treated under ERISA as jointly and severally liable for pension benefit liability.[57] However, according to the PBGC's General Counsel, ERISA is not explicit – and it has not been tested in a U.S. court – whether PBGC liens against *other* U.S.-based assets or subsidiaries of a foreign company, which are outside the controlled group sponsoring the pension plan, would be

---

[52] Complaint, *PBGC v. Asahi Tec Corp.*, No. 10-cv-01936 (District Court, D.C., filed November 12, 2010).

[53] Latham & Watkins Tax Department, "Asahi: The PBGC's Continued Attack On Non-US Controlled Group Members," *Client Alert* No. 1122 (January 18, 2011), available at http://www.lw.com/Resources.aspx?page=FirmPublicationDetail&publication=3910.

[54] "PBGC Tells Bendix to Pay $16.9 Million in Pension Debt," PBGC News Release No. 10-23, February 04, 2010.

[55] "PBGC to Pay Pension Benefits at Böwe Bell + Howell Co.," PBGC News Release No. 11-27, March 17, 2011.

[56] Latham & Watkins Tax Department, "Asahi: The PBGC's Continued Attack On Non-US Controlled Group Members," *Client Alert* No. 1122 (January 18, 2011), at p. 3, available at http://www.lw.com/Resources.aspx?page=FirmPublicationDetail&publication=3910.

[57] *See* PBGC, Opinion 97-1 (May 5, 1997).

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

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

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

The enforcement of ERISA's fiduciary duty rules is at the heart of the Department of Labor's mission to safeguard retirees' pension assets and promised benefits. Indeed, DOL's Employee Benefits Security Administration has a pending rulemaking that proposes to extend and strengthen the rules to make additional parties, such as pension consultants, subject to liability as a fiduciary.[58] ERISA Section 409(a) imposes liability on a breaching fiduciary to (i) make restitution to the plan for losses resulting from the breach; (ii) disgorge profits obtained by the fiduciary as a result of the breach of duty; and (iii) be subject to other equitable or remedial relief deemed appropriate by the court, including removal of the fiduciary. ERISA Section 409(a) also provides for the personal liability of fiduciaries, stating in part:

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

This strict standard of accountability is negated if a company or person can act as a fiduciary with respect to the administration or control of plan assets while remaining immune from the judgment of a U.S. court. Both the current and proposed definitions of fiduciary will prove meaningless in a growing number of situations where plan participants, the DOL and the PBGC will be unable to hold certain foreign fiduciaries accountable even for knowing and willful breaches of fiduciary duty that deplete plan assets. Many American firms have been acquired by or merged with foreign entities, leaving the pension plan sponsors as subsidiaries of non-U.S.-based parent. As a result an increasing number of foreign-based entities are assuming the role of "named fiduciaries," as defined by Section 402 of ERISA, with respect to control or management of the assets of the plan, as well as the designation of other subordinate fiduciaries

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

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

[58] DOL/EBSA, "Definition of the Term 'Fiduciary', Proposed Rule, 75 Fed. Reg. 65263 (Oct. 22, 2010). ERISA straightforwardly provides that a person who renders investment advice for direct or indirect compensation is a fiduciary. The current regulatory definition, adopted by the Department in 1975, and not updated since, unduly limits the parties potentially liable as fiduciaries by instituting a five-part test, each element of which must be met for giving investment advice to be a fiduciary function. See 29 CFR §2510.3-21(c).

By regulation, DOL has generally taken pains to ensure that plan "assets are under the management and control of a fiduciary which is a corporation or partnership organized under the laws of the United States . . . [and] has its principal place of business within the United States and which is" a bank, insurance company or registered investment adviser under U.S. regulation and with substantial net worth or equity.[59] Where a foreign entity, such as a foreign securities depository, holds the indicia of ownership, DOL regulations require that it does so only as an agent for the U.S. bank or other entity that is subject to the jurisdiction of U.S. district courts, which in turn remains "liable to the plan to the same extent it would be if it retained the physical possession of the indicia of ownership within the United States."[60]

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

Section 502(a)(3) of ERISA provides that a civil action may be brought by a participant, beneficiary or fiduciary to recover benefits, to enjoin any act or practice which violates Title I or the terms of the plan, or to obtain any other appropriate equitable relief to redress a fiduciary breach. In general, this private right of action has greatly benefited plan participants, resulting in well over 1,000 fiduciary lawsuits in U.S. court and no doubt deterring countless more.[61] But unless DOL updates its rules to ensure that ERISA fiduciaries subject themselves to the jurisdiction of U.S. courts, in an increasing number of cases plan participants will have no effective remedy vis-a-vis foreign fiduciaries in the American court system. It is an empty exercise to determine that an individual or firm is an ERISA fiduciary and liable for a breach of ERISA fiduciary duties if that party is not subject to the jurisdiction of U.S. courts.

Plan participants also rely on DOL enforcement both for actual financial recoveries and for its wider deterrent effects. The EBSA reports its many fiduciary enforcement actions on the Department of Labor Web site.[62] As part of its stepped-up enforcement program, EBSA filed up to 24 lawsuits against fiduciaries in a single day last year.[63] Effective jurisdiction over breaching fiduciaries is also essential for the recovery of assets by the PBGC in the aftermath of a distress termination, which frequently results in the agency pursuing a bankrupt plan sponsor and/or controlled group members for additional contributions to a pension plan with assets substantially less than its termination liability. Even a judgment in favor of the agency, or of plan participants, which orders restitution or the disgorgement of ill-gotten profits, could generally not be enforced against a fiduciary lacking assets under the jurisdiction of U.S. courts.

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

[59] 29 C.F.R. §2550.404(b)-1(a).

[60] 29 C.F.R. §2550.404(b)-1(a)(2)(ii)(C).

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

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

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

As explained above, one of the PBGC's few tools to intervene in a spin-off or other M&A transaction that threatens the long-term solvency of the pension plan is to threaten to seek a federal court's approval to initiate an involuntary termination of the plan, making the plan sponsor immediately liable for any under-funding. Since the PBGC calculates this liability as if the present value of every future pension payment had to be paid immediately (and not offset by future investment returns on plan assets), an ongoing plan that is 85% funded under ERISA standards may be 60% funded on a PBGC termination basis. If the PBGC can credibly convince a court that an involuntary termination is justified in order to prevent an even larger loss down the road, the prospect of this immediate liability may be enough convince the company to negotiate additional contributions or guarantees (e.g., bonds or liens on tangible assets). And, as noted above, the PBGC has become increasingly aggressive in convincing a handful of companies each year to shore up their plans at least to some degree.

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

First, because of the statutory language, the PBGC's threat of a possible involuntary termination is not credible unless it is prepared to persuade a federal judge that the plan's "possible long-run loss" is "reasonably expected to increase unreasonably if the plan is not terminated."[64] This is a high bar that the PBGC has made even higher by adopting an internal policy that it should not proceed in such cases unless it is "highly likely" that the plan will end up in a distress termination. In practice, it seems to require (as in the recent examples noted above) that the plan is both under-funded *and* that the ongoing profitability of the corporate entity responsible for future contributions is very suspect.

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

Third, even if the PBGC calls the company's bluff and goes to court, a judge will be more reluctant to rule in its favor – over the company's objections – when the only option is an involuntary termination that the court knows will impose permanent losses on many plan participants, as well as potential future losses on taxpayers (by adding to the PBGC's deficit).

Fourth, and perhaps most significantly, the PBGC is limited to asking the court to approve termination. In a series of exit memos suggesting needed reforms, former PBGC Executive Director Bradley Belt argued the agency needed the sort of authority a bank regulator or the Securities and Exchange Commission has to seek remedies short of the "nuclear option" – options that help rather than harm plan participants, such as a cease and desist order, an increase in the plan funding, or a lien on tangible assets that could help pay benefits if the firm declares bankruptcy. "PBGC's primary authority in this regard is to initiate plan termination, which we have used effectively, but which is also a very blunt instrument that can result in a

[64] ERISA Section 4042(a)(4).

high-stakes game of brinksmanship," Belt wrote. "Other government or Congressionally-chartered entities that provide a financial guaranty, particularly the FDIC, but also OPIC, Ex-Im Bank, and SIPC, have a much broader tool set at their disposal to avoid losses and manage risks than does the PBGC."[65]

Finally, as a practical matter neither the Early Warning Program nor the§ 4042(a)(4) "nuclear option" reach transactions such as the strategic sale or spin-off of under-performing divisions or subsidiaries by financially healthy firms. A classic example is Verizon's 2006 spin-off of its declining Yellow Pages unit into a new public company called Idearc that went into bankruptcy less than three years later. As Verizon and its competitors make broadband Internet access ubiquitous, it was clear even then that printing and delivering five-pound piles of paper free to every home was a business living on borrowed time. But while it was smart strategically for Verizon to spin-off the Yellow Pages, it was likely a breach of fiduciary duty to load onto that sinking ship the liability for vested benefits earned many years earlier by 2,000 Verizon retirees.

Unfortunately, because Verizon's pension plan at the time was fully funded – and the company is not financially weak – this increasingly common brand of strategic spin-off does not fall within the scope of the PBGC's Early Warning Program. And even if it did, it may have been difficult to convince a court that a fully-funded Verizon spin-off was highly likely to end up in bankruptcy any time soon. But bankruptcy is where Idearc landed; and although the company emerged from bankruptcy with a new name (SuperMedia) and its pension plan intact, the former Verizon retirees are currently fighting to recover lost health and welfare benefits through a class action suit supported by the Association of BellTel Retirees.[66]

Regulators need the ability to temporarily enjoin a spin-off or other M & A activity and convince a court that a more tailored remedy, short of plan termination, is appropriate and practical. Like a bank regulator or commercial creditor addressing a heightened risk of insolvency, the PBGC should be able to go in and negotiate with a plan sponsor with the leverage of knowing that it can go into District Court and seek approval for remedies short of plan termination. These would not be novel remedies for a regulatory – and could permit a court-approved outcome more tailored to the risk of increased loss to PBGC (and to retirees). The remedies could include a cease and desist order, a schedule of contributions that restore full funding or, most usefully, warrants or other secured obligations (such as liens on tangible assets) equal to the current or projected termination liability. If in fact the spin-off or other transaction does not lead to a distress termination within a certain number of years, the guarantees would expire and the parties would be no worse off. But if in fact the spun-off division – or the shell of a parent left behind – end up filing for bankruptcy and a distress termination of their pension obligations, both the PBGC and the retirees and other participants would be better protected against loss.

D. The 20% Layoff Threshold Under § 4062(e) Should be Broadened

As described in the previous section, the other major statutory tool that gives the PBGC leverage to negotiate additional payments to shore up plan under-funding is the "Substantial Cessation of Operations" provision of ERISA Section 4062(e). The statute provides that if "an employer ceases operations at a facility in any location" that results in more than 20% of the active "employees who are participants under a plan" separating from employment, the employer becomes immediately liable for that same percentage of the plan's total unfunded liability calculated on a termination basis. Used aggressively, the partial

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

[66] Senior Federal Judge A. Joe Fish of the Northern District of Texas, Dallas Division, issued an order granting class certification for participants on February 28, 2011. *See* Amended Class Action Complaint, *Murphy et al. vs. Verizon,* available at **http://www.belltelretirees.org/images/stories/docket06-amendedcomplaint.pdf**

termination liability triggered by major plant closings or mass lay-offs under Section 4062(e) allows the PBGC to shore up the funding of impacted plans to some degree. However, while useful, the statutory provision is far too narrow, leaving most participants who are negatively impacted by corporate restructurings or changes in ownership unprotected.

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

Congress should consider broadening at least somewhat the definition of events that trigger immediate liability for under-funding pursuant to Section 4062(e). Although plant closing and resulting mass lay-offs were the foremost threat Congress had in mind at the time it added the protection in § 4062(e), today the threat of transactional restructuring can be equally devastating to retirement security and the ability of PBGC to ward off a taxpayer-funded bailout.

For example, the transfer of more than 20% of the liabilities of a pension plan to a different controlled group – including through a spin-off or takeover – should similarly trigger immediate liability to ensure full funding of the transferred benefit liabilities. This would also fill the gap left by Internal Revenue Code Section 414(l) which, as noted in the section above, exempts plan liabilities transferred to "an employer who is not a member of the same controlled group as the employer maintaining the original plan."[67]

An updated trigger should also address the converse threat: that a plan sponsor will spin-off the firm's most productive and profitable division(s), leaving the legacy pension obligations (or a disproportionate share of them) behind in a likely-to-fail shell company. Recall that this was the PBGC's concern in December 2010 when Motorola announced that it would spin-off its mobile handset business into a new company ("Motorola Mobility"), but leave all pension liabilities with the original company ("Motorola Solutions"), which would have less revenue to support contributions to the already-under-funded plan. To avoid this loophole, the transfer of more than 20% of a plan sponsor's assets or revenues to a different controlled group – including through a spin-off or sale – should similarly trigger immediate liability to ensure the full funding of the plan's vested benefit liabilities.

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

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

Under its Early Warning Program, the PBGC currently monitors about 1,100 companies which it screens on the basis of significant underfunding (more than $50 million), or because of a combination of financial weakness (below-investment grade bond ratings) and under-funding in excess of $5 million. In addition,

[67] I.R.C. § 414(l)(2)(D)(ii).

the PBGC also monitors notifications of a wide range of "reportable events" (see above), some of which are provided in advance, although these are required from public companies only 30 days *after* a transaction. However, it does not appear that the PBGC routinely monitors and reviews in advance two types of transactions that expose the agency and retirees to potentially greater risk of loss: spin-offs (whether or not pension liabilities are transferred) and acquisitions, takeovers or mergers of a U.S. plan sponsor by a non-U.S. firm (whether in whole or in substantial part).

It's clear from many of the examples in this paper that certain corporate transactions – particularly the spin-off of under-performing subsidiaries – are very likely to increase the long-term risk of distress termination and benefit loss for retirees transferred in the deal. Strategic spin-offs of under-performing units is a well-established tactic that holds even greater appeal when legacy pension, health and welfare benefits can be taken off the books of the parent company. Almost any announced spin-off, spit-up or sale of a division by a U.S. company with legacy defined-benefit liabilities should send up a bright red warning flare that the retirees (and quite possibly the American taxpayer) will end up subsidizing the transaction if the now stand-alone unit deteriorates into bankruptcy. While the PBGC will quickly determine that the majority of mergers, acquisitions, spin-offs and takeovers will not impact a defined-benefit plan at all, or not adversely, it will also certainly identify an additional dozen or more major transactions each year that will deserve closer scrutiny. However, particularly in cases where no pension liabilities will be transferred along with the spin-off, it will be equally important for the PBGC to review – as the agency did with Motorola's split-up late last year – whether the parent is being hollowed out and left with a weakened ability to support the legacy pension benefits left behind.

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

IV. POLICY RECOMMENDATIONS TO PROTECT RETIREES AND LIMIT PBGC LOSSES

The five gaps in protections for retirees in the context of corporate mergers, acquisitions and spin-offs described just above will grow wider each year as both globalization and corporate financial engineering continues apace. The economic environment is very different – and far more dangerous for retirement security – than it was in the 1970s or 1980s when ERISA was adopted and first refined. While it is important not to impede the greater productivity, profitability and efficiency that result from a very large percentage of corporate transactions and restructurings, it is equally important to update the rules of the road to ensure that plan sponsors and fiduciaries do not abuse gaps in the law and in enforcement to deny retirees and workers any part of their earned pension benefits, or to transfer a share of those losses onto taxpayers by abandoning an under-funded plan to the PBGC.

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

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

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

According to the PBGC's General Counsel, ERISA is not explicit – and it has not been tested in a U.S. court – whether PBGC liens against *other* U.S.-based assets or subsidiaries of a foreign company, which are outside the controlled group sponsoring the pension plan, would be enforced by either a U.S. or foreign court. For example, the foreign parent of a U.S. subsidiary could have other unrelated subsidiaries or assets located within the jurisdiction of U.S. courts. While the PBGC has correctly taken the position that all of a foreign controlled group's U.S.-based assets should be subject to liens for non-payment of U.S. pension liabilities, it would greatly strengthen the hand of both the agency and plan participants if Congress would clarify that explicitly under ERISA section 4068, which gives the PBGC authority to impose liens.

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

Pension plan participants as well as the PBGC have the right to sue pension plan fiduciaries in U.S. courts for breach of fiduciary duty and to recover plan assets.[68] The DOL and PBGC have on many occasions pursued restitution from exercised federal authority to seek judgments from individuals who acted as fiduciaries of pension plans where they have breached their fiduciary responsibilities, resulting in a loss of plan assets. However, the assignment of individuals as fiduciaries who are not U.S. citizens by a foreign corporation, or who may not even be domiciled on U.S. territory, can put the fiduciary beyond the reach of U.S. courts and eviscerate intended protections in ERISA.

The Department of Labor should revise its regulations related to breaches of fiduciary duty to **clarify that fiduciaries under ERISA – at a minimum contributing sponsors and "named fiduciaries" – must be subject to the jurisdiction of federal district courts with respect to the enforcement of judgments for potential breaches of fiduciary duty**. DOL should clarify that at a minimum all "named fiduciaries," as defined by Section 402 of ERISA, must be

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

(2) jointly liable for the fiduciary breaches of other fiduciaries who they designate under Section 405(c)(1) and who they know, or reasonably should have known, are not subject to the jurisdiction of U.S. courts for the purpose of enforcing judgments under ERISA.[69]

ERISA's otherwise strict standard of accountability is negated if a person or firm can act as a fiduciary with respect to the administration or control of plan assets while remaining immune from the judgment of a U.S. court. And while U.S.-based companies and individuals are held accountable, Congress and DOL have so far ignored the increasing trend toward non-U.S. firms and fiduciaries that can potentially escape liability by abandoning underfunded pension plans. If DOL does not act, Congress should ensure that ERISA fiduciaries, especially named fiduciaries, are subject to the jurisdiction of U.S. courts.

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

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

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

The PBGC's authority to seek additional plan contributions, guarantees or other remedies under ERISA section 4042(a)(4) is too limited. **Regulators need broader and more flexible authority under section 4042(a) to negotiate or seek court approval for a more tailored remedy, short of plan termination, to address spin-offs, split-ups or other material transactions that greatly increases the risk of future loss**.

Section 4042(a) should be amended so that in addition to initiating a voluntary termination, the PBGC would also have the sort of authority a bank regulator or the Securities and Exchange Commission has to seek remedies short of the "nuclear option" of involuntary plan termination – options that would help rather than harm plan participants. These more modest and tailored remedies should include the ability to seek a cease and desist order, an increase in plan contributions, or a bond or lien on tangible assets that could help pay benefits if the firm declares bankruptcy and abandons its plan in the future.

4. *Broaden the Trigger for Immediate Funding Liability Under ERISA § 4062(e)*

A plan sponsor's immediate liability to ensure funding for vested benefits, calculated on a termination basis, is triggered under ERISA section 4062(e) *only if* more than 20% of the *active* plan participants are separated from the plan, most commonly due to a plant closing or mass layoff. Although this "Substantial Cessation of Operations" provision gives the PBGC leverage to shore up under-funding in certain situations, the statutory trigger is far too narrow, leaving most participants negatively impacted by spin-offs or other corporate restructurings unprotected.

Congress should expand the events that trigger immediate liability for under-funding pursuant to Section 4062(e) to include certain other transactions that pose even greater risk to *all* plan participants, including spin-offs, control group break-ups, and takeovers by foreign-owned firms. While this could be done a number of ways, the current 20% threshold could be extended to include:

- the transfer of more than 20% of a firm's under-funded pension liabilities to a different controlled group – including through a spin-off or takeover – should similarly trigger immediate liability for full funding of the transferred liabilities (calculated on a termination basis).

- the transfer of more than 20% of an under-funded plan sponsor's corporate assets, or revenues, to a different controlled group – including through a spin-off or sale – should similarly trigger immediate liability for full funding of plan liabilities (calculated on a termination basis).

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

5. *The PBGC's Early Warning Program Must Review Spin-Offs and Sales to Non-U.S. Firms*

The PBGC should add foreign ownership, and proposed sales or spin-offs to foreign owners, along with such transactions among U.S. corporations, to the list of transactions triggering special scrutiny under the PBGC's Early Warning Program and, if possible, to the list of transactions requiring an Advance Notice of Reportable Events. As the list of reportable events suggests (see Box above), nearly every other significant change in corporate structure or in the controlled group contributing to the plan is subject to Risk Mitigation Program reporting *except* foreign acquisition.

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

Conclusion

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