Defined Benefit Plan Sponsors Beware – Potential Liability Related to Facility Closings and Sales of Business Units

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Employers who maintain a defined benefit pension plan and who are considering a facility shutdown or sale need to be aware of potential liability under ***ERISA*** Section 4062(e), as recently amended by ***Congress***.

ERISA Section 4062(e) provides for potential employer liability when an employer ceases operations at a facility, resulting in a set percentage of a defined benefit pension plan's participants being terminated. However, this single sentence provision was largely ignored for the first 30 years of ERISA. In 2006, the ***Pension Benefit Guaranty Corporation (PBGC)*** issued regulations regarding application and calculation of this liability, and in 2012 created an enforcement policy. Enforcement came as a surprise and resulted in an often unwarranted hardship on affected employers. As a result of numerous complaints, Congress began reexamining this provision and the PBGC issued an enforcement moratorium in 2014.

On December 16, 2014, ***President Obama*** signed legislation revising Section 4062(e). While the revised statute is somewhat more relaxed, it still provides for potentially significant employer liability. Further, the PBGC has lifted its enforcement moratorium, which means employers with defined benefit plans should carefully review Section 4062(e) and related guidance before closing or selling off a facility.

Set forth below is a short summary, in Q&A format, designed to provide a general understanding of Section 4062(e).

1. **What plans are subject to Section 4062(e)?** A plan subject to Title IV of ERISA (*e.g.*, a defined benefit pension plan) is generally subject to this provision if the plan has 100 or more participants with accrued benefits. However, if the plan is 90 percent or better funded as of the first day of the plan year before the cessation occurred, the plan is exempt.

2. **What triggers ERISA §4062(e)?** Section 4062(e) applies when an employer has a permanent cessation of operations at a facility that results in a reduction in the number of eligible employees equal to 15 percent of all eligible employees of the employer. While this is

a lower percentage than the 20 percent reduction used in the original version of Section 4062(e), the definition of eligible employees is expanded to include any employee eligible for an employee pension plan (including a 401(k) plan) maintained by the employer.

DBR Note: Because employees eligible for any employer pension plan (including defined contribution plans) rather than just the subject pension plan are included, the denominator for determining the workforce reduction percentage is likely larger. Thus, even though the percentage has decreased, it may be harder to hit the percentage given the larger base of employees considered.

The PBGC has taken the position that a sale or other distribution can result in a permanent cessation of operations at a facility. Amended Section 4062(e) continues this position but provides that employees will not be taken into account in computing the workforce reduction if the buyer’s plan assumes the plan assets and liabilities for the employee and the employee either continues to work with the buyer or the buyer replaces the employee with an employee who is a citizen or resident of the United States.

3. **What happens if an employer triggers Section 4062(e)?** As a starting point, if an employer triggers Section 4062(e), the employer must make additional contributions to the plan or provide some financial guarantees to the PBGC. The amount is based on the PBGC termination liability as of the cessation date multiplied by the number of employees terminated as a result of the cessation divided by the total number of current employees immediately prior to the cessation. The PBGC will work with the employer but may require that the employer pay a specified amount to the PBGC to be held in escrow as a guarantee in the event the plan is terminated following the cessation. This escrow amount is returned to the employer (without interest) if the plan is not terminated during the five-year period following the cessation. Alternatively, the employer can purchase a bond for the guarantee. Amended Section 4062(e) provides a new alternative method for satisfying the Section 4062(e) liability. Under this new method, the employer may contribute to the plan annual installments over a seven-year period. Each installment is 1/7 of the unfunded vested benefit times the reduction percentage (*i.e.*, the number of participants with accrued benefits who were terminated due to the reduction divided by the number of participants with accrued benefits). The installments cease if the plan becomes 90 percent funded.

DBR Note: While making plan contributions over a seven-year period may be more palatable to an employer than posting a bond or putting money interest-free in an escrow with the PBGC, the bottom line is that Section 4062(e) still imposes an added (and often unexpected) expense on the employer.

4. **Are there any exceptions to liability?** Pursuant to the PBGC’s enforcement policy, companies that can prove they are financially sound will not be required to satisfy Section 4062(e) even if they experience a substantial cessation and are under 90 percent funded.

DBR Note: Although the PBGC adopted its enforcement policy prior to amendment of Section 4062(e), the PBGC has indicated that it is still in effect. Under this enforcement policy, the PBGC considers a company to be financially sound if (a) the company has unsecured debt-equivalent ratings of at least Baa3 from Moody's and BBB- from Standard & Poor's; (b) the company is rated Baa3 or BBB- by Moody's or Standard Poor's; or (c) the company is not rated but has a Dun & Bradstreet Financial Stress Score of 1477 or higher and its secured debt (other than debt to purchase real estate and equipment) does not exceed 10 percent of its asset value.

5. **When is the amended Section 4062(e) effective?** Amended Section 4062(e) applies to any cessation of operations or similar event that occurs after December 16, 2014. However, an employer that had a cessation prior to that and that had not already entered into an agreement with the PBGC, may elect to apply the new provisions. In order to apply the new provisions to an earlier cessation, the employer must elect no later than 30 days after the PBGC issues a final determination that a cessation of operations occurred. Further, amended Section 4062(e) prohibits the PBGC from taking any action inconsistent with amended Section 4062(e), regardless of when the cessation occurs.

DBR Note: While not entirely clear from the language, it appears that the election that must be made to apply amended Section 4062(e) applies to the new seven-year period for making plan contributions. Employers currently working with the PBGC regarding an earlier cessation will want to coordinate with the PBGC to understand any notice obligations that must be met.

The PBGC has indicated that it is reviewing amended Section 4062(e) and will be providing further guidance and information regarding its implementation. In the meantime, the PBGC has lifted its enforcement moratorium. As a result, employers with Title IV plans who are contemplating a plant shutdown or selling a division that will result in a substantial cessation should take a close look at whether they will trigger Section 4062(e). Those who already closed or sold a facility will want to consider the new provisions to determine if the employer actually experienced a substantial cessation of operations and whether the new seven-year payment period will provide an acceptable means of addressing the employer liability.

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