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## **EBEC (Employee Benefits / Executive Compensation) Law Update**

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### **PROPOSED REGULATIONS UNDER ERISA § 4062(e) - CESSATION OF OPERATIONS WITH MORE THAN 20% REDUCTION IN PLAN**

For a defined benefit pension plan subject to Title IV of ERISA, under ERISA § 4062(e), 29 U.S.C.A. § 1362(e), if there is a cessation in operations at a facility in any location, and as a result of such cessation more than 20% of plan participants are separated from employment, the employer is treated as if it were a substantial employer under a multiple employer plan, and notification of the PBGC together with an escrow or bond requirement would apply. This provision is often used by the PBGC in transactions to extract concessions from, e.g., a parent company selling a facility.

Proposed § 4062(e) PBGC regulations issued in August of 2010 provide guidance on applicability and enforcement of § 4062(e), defining "cessation of operation" and "separation from employment," providing certain default assumptions, and setting forth the PBGC investigative authority, the employer's reporting requirements and liability for a § 4062(e) event.

#### ***Background Regarding ERISA § 4062(e)***

*Cessation of Operations With More Than 20% Reduction in Plan.* Under ERISA § 4062(e), 29 U.S.C.A. § 1362(e), if there is a cessation in operations at a facility in any location, and as a result of such cessation there is more than a 20% reduction in plan participation, the employer is treated as if it were a substantial employer under a multiple employer plan, and notification of the PBGC together with the escrow or 150% bond would apply under ERISA § 4063.

*Notice Within 60 Days and Annual Report.* Notification must be made within 60 days after the event. ERISA § 4063(a). An annual report under § 4065 is required which must include a copy of each notification required under ERISA under § 4063.<sup>1</sup>

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<sup>1</sup> For early application of ERISA § 4062(e) which has been limited prior to issuance of regulations, see, e.g., PBGC Opinions 86-13 and 85-8 (spinoff alone may not trigger § 4062(e)); PBGC Opinions 78-29, 76-52, 75-117 and 82-29 (in an asset sale where buyer continues plan, § 4062(e) will not be triggered); PBGC Opinion 77-147 (if fully funded at date of sale, PBGC would not impose liability). These PBGC letters indicate that an asset sale is not by itself a cessation of operations. However, most of these letters involved cases where there has been a transfer of assets and liabilities to the buyer's plan, and some PBGC officials have argued that § 4062(e) liability should apply to an asset sale where pension

*Escrow or Bond or Other Arrangement.* The PBGC has discretion whether to seek the escrow or the 150% bond under ERISA §§ 4063(e) & 4067. If the plan terminates in a distress or involuntary termination within five years the escrow or bond amount will be applied against the plan's underfunding. Otherwise the escrow or bond are returned to the employer. Section 4063(e) allows PBGC to waive liability if there is an appropriate indemnity agreement and § 4067 authorizes PBGC to make alternative arrangements the satisfaction of liability.<sup>2</sup>

*Calculation of Liability.* Under regulations issued in 2006, the liability under § 4063(b) (which would be applied to the plan in certain terminations as described, and of which 100% is required for escrow and 150% is required for bond) is calculated, according to 2006 regulations, based on the § 4062 liability multiplied by the ratio of the employee/participants who are separated from employment because of the cessation of operations to the total number of employee/participants of the employer.<sup>3</sup>

*Increase in Enforcement.* There has been a significant increase in enforcement under § 4062(e) since the issuance of the final regulations in 2006.<sup>4</sup> The cases typically settle with agreements with the PBGC for escrow or bond, letter of credit, security interest, additional contributions, guarantees by controlled group entities, etc.

### ***Proposed 2010 Regulations***

Proposed § 4062(e) PBGC regulations issued in August of 2010 provide guidance on applicability and enforcement of § 4062(e).<sup>5</sup> The proposed regulations provide as follows.

*Cessation of Operations at a Facility and More than 20% Reduction in Participants in the Single Employer Plan.* A § 4062(e) event occurs only if (i) the plan is maintained by an employer, (ii) the plan is a single-employer plan that is not a multiple employer plan, (iii) the employer "ceases" an "operation" at a "facility" in any "location," (iv) as a result, more than 20% of active participants are separated from employment.<sup>6</sup>

- The plan must be maintained - but need be established - by the employer.
- Section 4062(e) is not dependent on there being a risk to the employer.

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liabilities for the transferred employees remain with the seller. Ashner, "Beware of PBGC Downsizing Liability," 15 J. of Pen. Benefits (Spring 2008).

<sup>2</sup> The PBGC has in fact waived the bond or escrow requirement where the purchaser's net income for the prior three years was 150% or more of the security required, or its net tangible assets are worth at least as much as the amount that would have to be posted in bond or escrow. See below regarding proposed 2010 regulations.

<sup>3</sup> PBGC Reg. § 4062.8, proposed in 70 Fed.Reg. 9258 (Feb. 25, 2005), and finalized in 71 Fed.Reg. 34819 (June 16, 2006). These would be revised slightly and moved to § 4062.32 under the 2010 proposed regulations as described below.

<sup>4</sup> ABA JCEB Q & As for PBGC (May 2008), Q & A 18. See also, Hennessey, "Defined Benefit Plans in Corporate Transactions," ABA National Institute on Employee Benefits in M&A Transactions, (March 19, 2008) (increased enforcement of § 4062(e) because of clarification of liability under PBGC Reg. § 4062.8 finalized in June of 2006).

<sup>5</sup> Prop. Amendments to PBGC Reg. §§ 4062.21 - 4062.35, 75 Fed. Reg. 48283 (Aug. 10, 2010).

<sup>6</sup> Prop. PBGC Reg. § 4062.23(a).

- If there are two or more plans of the employer § 4062(e) applies to each separately.<sup>7</sup>

*Definition of Operation.* “Operation” is defined as set of activities that constitutes an organizationally, operationally or functionally distinct unit of the employer.<sup>8</sup> “Facility is the place(s) where the operation is performed.<sup>9</sup> This could be a single building or enclosed structures. A facility may have more than one operation.<sup>10</sup>

- If a facility has more than one operation § 4062(e) may apply even where some but not all of the activities at the facility ceased.

*Definition of Cessation of Operations.* Whether a "cessation" of operation has occurred depends on whether the discontinuance is a mere cutback, contraction or curtailment, or is so thorough that the conduct of the operation at the facility can no longer be considered on-going, as stated in the Preamble. In a voluntary employer cessation, the test will be whether the employer discontinues all significant activity at the facility in furtherance of the purpose of the operation (even though insignificant activity continues, such as sales of left-over inventory or continuance of maintenance and guard services).<sup>11</sup>

*Permanent Cessation of Operations.* For “involuntary” discontinuance caused by events outside the employer’s control, the employer should have an opportunity to react to resume or not to resume the activity before discontinuance is characterized as a cessation under § 4062(e), as stated in the Preamble. In such cases, cessation would occur not when all significant activity stopped, but at a later date unless the employer in the meantime resumed the operation at the facility, as stated in the Preamble. Where the discontinuance of activity was caused by employee action, such as a strike or sickout, the cessation date would be the date the employee action ended (and the employer would have a week in which to resume activity).<sup>12</sup> Where the discontinuance was caused by an outside unanticipated event such as a natural disaster, the cessation date would be deferred for 30 days, which would be time enough to resume work if the event causing the discontinuance left the operation viable.<sup>13</sup>

*Definition of Separation from Employment.* A "separation from employment" occurs when the employee discontinues active performance with the employer for any of the employer's operations.<sup>14</sup>

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<sup>7</sup> Prop. PBGC Reg. § 4062.23(b).

<sup>8</sup> Prop. PBGC Reg. § 4062.24.

<sup>9</sup> Prop. PBGC Reg. § 4062.25.

<sup>10</sup> Id.

<sup>11</sup> Prop. PBGC Reg. § 4062.26(a).

<sup>12</sup> Prop. PBGC Reg. § 4062.28(b)(1).

<sup>13</sup> Prop. PBGC Reg. § 4062.28(b)(2).

<sup>14</sup> Prop. PBGC Reg. § 4062.27(a).

- If it is reasonably certain that the employee will return to work within 30 days it is not a separation from employment until the participant does not return to employment by that 30 day period. The separation is disregarded if as of the cessation date the employee has been rehired or has been replaced by another employee-participant.<sup>15</sup>
- If the employee is transferred from one facility to another there is no separation from employment as stated in the Preamble.

*Separation of Employment as Result of Cessation of Operations.* The separation must be a result of the cessation of operation.<sup>16</sup> For example, if the employee retires on schedule at the time of the cessation of operations this is not a separation as a result of cessation of operations, as noted in the Preamble.

*Presumptions Regarding Separation of Employment as Result of Cessation of Operations.* The following presumptions are made by the proposed regulations:

(i) If the employee involuntarily separates from employment on or after the date the employer decides to cease operations, the employee has separated from employment as a result of the cessation.<sup>17</sup>

(ii) If the employee voluntarily separates after the employer decision to cease operations becomes known, this separation results from the cessation.<sup>18</sup>

(iii) If an employee separates from employment with the employer but becomes employed by a new employer who resumes the operation at the facility, there WILL be a separation from employment.<sup>19</sup>

- This is in contrast to other areas of the law where immediate reemployment by a buyer would not be considered a loss of employment.

The active participant base associated with a cessation is total number of persons who immediately prior to the date of cessation of operations (generally for involuntary cessations) or the date of the employer decision to cease operations (for voluntary cessations) were employed in the operations.<sup>20</sup>

*PBGC Investigative Authority.* The PBGC has authority to make investigations as it considers necessary to enforce § 4062(e). Any PBGC information requests must be answered within 45 days. Based on information obtained the PBGC may determine that a § 4062(e) event has occurred and determine the amount of liability.<sup>21</sup>

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<sup>15</sup> Prop. PBGC Reg. § 4062.27(b).

<sup>16</sup> Prop. PBGC Reg. § 4062.28(a).

<sup>17</sup> Prop. PBGC Reg. § 4062.28(c).

<sup>18</sup> Prop. PBGC Reg. § 4062.28(d).

<sup>19</sup> Prop. PBGC Reg. § 4062.28(f).

<sup>20</sup> Prop. PBGC Reg. § 4062.29.

<sup>21</sup> Prop. PBGC Reg. § 4062.30.

*Reporting Requirements.* Section 4062(e) refers to § 4063 which requires a notice for withdrawal of a substantial employer within 60 days after the event. The proposed § 4062(e) regulations specify that the plan administrator must notify the PBGC of a § 4062(e) event within 60 days after the later of cessation of operations or the date the affected participants is more than 20% of active participants.<sup>22</sup> Draft PBGC Form 4062-E is posted on the PBGC website.<sup>23</sup>

- The \$1,100 per day penalty pursuant to PBGC § 4071 would apply to late filing of notice, as stated in the Preamble.

*Liability for § 4062(e) Event.* As provided in 2006 regulations but clarified and slightly modified in the 2010 proposed regulations, the amount of liability for a § 4062(e) event is what the PBGC determines to be the amount described in § 4062 for the entire affected plan, computed as if the plan had been terminated by PBGC immediately after the cessation date, multiplied by a fraction - the numerator of which is the number of affected participants, and the denominator of which is the active participant base. 4062.32(b). This amount is calculated without regard to any change in the plan's assets or liabilities after the cessation date. 4062.32(c).

*Manner of Satisfying Liability.* Regarding escrow/bond requirement, the 2010 proposed regulations provide that in general, PBGC will require that liability for a § 4062(e) event be satisfied by paying the amount of the liability to PBGC to be held in escrow under § 4063(b) or by furnishing a bond not exceeding 150% of the liability under § 4063(c)(1). Alternatively, PBGC may make other arrangements for satisfaction of liability for § 4062(e) event, (i) by permitting liability to be satisfied through one or more additional plan funding contributions that would not be added to the plan's prefunding balance, or (ii) where the affected operation is continued by new employer which employs persons previously employed by the current employer, by the new employer's adoption or maintenance of the affected plan or of a plan that holds substantially all of the liabilities and assets of the affected plan attributable to affected employees.<sup>24</sup>

**IRS Circular 230 Disclosure:** To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. federal tax advice contained in this communication is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter that is contained in this document.

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<sup>22</sup> Prop. PBGC Reg. § 4062.31(a) & (b).

Nov. 2009 § 4043 PBGC reportable event proposed regulations would eliminate the need for separate § 4043 reportable event notice. Further, as stated in the Preamble to the August 2010 § 4062(e) proposed regulations, any information reported in a reportable event notice would not have to be reported again in a § 4062(e) notice

<sup>23</sup> [www.pbgc.gov/docs/Package\\_4062-E\\_ppsd.d10.pdf](http://www.pbgc.gov/docs/Package_4062-E_ppsd.d10.pdf)

<sup>24</sup> Prop. PBGC Reg. § 4062.33. The PBGC may waive any provision of the above proposed regulations,