

## 27<sup>TH</sup> ANNUAL ABI SPRING MEETING (APRIL 2009)

### PANEL: EMPLOYEE BENEFITS: PENSION PLAN LIENS: NATURE, SCOPE AND PECULIARITIES

#### DISCUSSION MATERIALS

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#### I. BACKGROUND

##### A. Financial Distress of Pension Plans

- The long term viability of America's pension plan system is threatened.
- Currently, 44 million American workers and retirees depend on future benefits from over 29,000 pension plans.
- At the end of 2008, according to press reports, the value of defined benefit pension plan assets plummeted, as did the average funded percentage -- from 100 percent to between 70 and 80 percent. *See e.g., Steven Taub, Pension Plan Plunges Spread Corporate Pain, CFO.com (December 2, 2008).*
- The PBGC's ability to guaranty defined benefit pension plans that terminate without sufficient funding to meet their commitments to retirees has been strained. PBGC has an "accumulated deficit" as of September 30, 2008, of \$11.15 billion.

##### B. The Pension Benefit Guaranty Corporation (PBGC)

- The PBGC is a wholly owned US Government corporation created under Title IV of the Employee Retirement Income Security Act of 1974 (ERISA). 29 U.S.C. § 1302 (2006).
- Modeled after the FDIC, the PBGC pays certain guaranteed benefits of terminated defined benefit pension plans to the plans' participants, subject to statutory maximums.

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- PBGC’s operations are financed by (i) insurance premiums paid by companies that sponsor defined benefit pension plans, (ii) the assets from terminated pension plans that PBGC takes over as trustee, (iii) recoveries from sponsors of the liabilities of terminated pension plans, and (iv) investment income.
- It is beyond the scope of this presentation to describe, or even to list, all the provisions of ERISA and its implementing regulations that bear directly or indirectly on PBGC collection and enforcement powers and procedures.

#### C. Pension Protection Act of 2006 (PPA 2006)

- Among other things, the PPA 2006 was a Congressional reaction to a series of bankruptcies in which pension plan restructuring played a significant role.
- It is beyond the scope of this presentation to describe the multitude of statutory revisions under the PPA 2006. Also, as a word of caution, the Act includes special airline provisions, which must be consulted where applicable. Nonetheless, at least two aspects of the PPA 2006 are worth noting.
- The requirement, generally effective as of 2008, to make “funding target” payments amortized over a period of seven years to remedy plan underfunding. PPA § 112(a)(1) and (c).
- In bankruptcy reorganizations, PBGC’s guarantee is determined as of the bankruptcy filing date, not the termination date of the plan. PPA § 404.

#### D. Worker Retiree and Employer Recovery Act of 2008

- Under the Worker Retiree and Employer Recovery Act, signed by President Bush on December 23, 2008, Congress provided modest relief to PPA’s tighter funding rules relating to, *inter alia*, asset smoothing, phase in of the PPA funding target, and at risk plans.

## II. PBGC LIENS

### A. Statutory Scheme

- The validity, extent, priority and perfection of PBGC statutory liens are determined with reference to both Title 29 (ERISA) and Title 26 (IRC).
- While the circumstances giving rise to such liens are set forth in both ERISA and IRC, for the most part, rules governing the extent, priority and perfection of the PBGC lien are set forth in the IRC, specifically § 6323.
- PBGC’s statutory liens under ERISA have the status of “taxes due and owing the United States” 26 U.S.C. § 430(k)(4)(C)(formerly § 412(n)); 29 U.S.C. § 1368(c)(2).

- PBGC has two distinct types of statutory liens: (i) Section 430(k) lien (formerly Section 412(n)) (arises upon a plan sponsor's failure to make mandatory quarterly or "catch-up" contributions to a plan) and (ii) Section 1368 lien (arises upon plan termination). Hereinafter, we sometimes refer to these as "funding liens" and "termination liens," respectively.

#### B. Section "430(k)" Lien – Missed Minimum Funding Contributions

- A Section 430(k) (formerly Section 412(n)) lien arises when the plan sponsor fails to make required minimum contributions to the pension plan, and such required contributions when added to the aggregate unpaid balance of previous unpaid contributions plus interest exceed \$1 million.
- As noted previously, effective 2008, Congress rewrote the minimum funding rules. The new minimum funding rules are more stringent. Sponsors of underfunded plans have to make "funding target" payments amortized over a seven year period to remedy plan underfunding. These obligations will likely cause more plans to trigger the \$1 million unpaid balance threshold which gives rise to the funding lien.
- Upon reaching the \$1 million unpaid balance threshold, the plan sponsor is required to inform PBGC within 10 days of the date it failed to make a required contribution. 26 U.S.C. § 430(k)(4)(A).
- The amount of the funding lien has no statutory limit. The amount of the lien represents the aggregate amount of all missed contributions, including interest. 26 U.S.C. § 430(k)(3).
- The statute provides for expiration of the funding lien only at the conclusion of the plan year when the missed contributions, plus interest, are less than \$1 million. 26 U.S.C. § 430(k)(4)(B).
- The funding lien is perfected and enforced by the PBGC for the benefit of the pension plan. The PBGC does not have the authority to extinguish the funding lien prior to the end of the plan year. As part of a workout or forbearance agreement, PBGC may withdraw the notice and/or subordinate the lien.
- *See also* Joel W. Ruderman, *Understanding a Pension Plan's Lien for Missed Minimum Funding Contributions*, Pension and Benefits Committee/ ABI Committee News, Vol. 2, No. 1 (Jan. 2007).

#### C. Section 1368 Lien - Pension Plan Terminations

- A Section 1368 lien arises upon plan termination, at which time the PBGC typically takes over the underfunded plan as statutory trustee and enforces the lien.

- The termination lien may not be in an amount in excess of 30 percent of the collective net worth of the plan sponsor and Controlled Group members (*see* Part II. D. below for definition of “Controlled Group”).
- A pension plan may be terminated in three ways: (i) a standard termination, (ii) a distress termination, and (iii) an involuntary termination. The first two are initiated by the plan sponsor, the third by the PBGC.
- To initiate a standard termination, a pension plan must have assets sufficient to fund all benefit liabilities or excess assets.
- Under ERISA, a pension plan sponsor satisfies one of the four statutory tests for distress, if: (1) the plan sponsor is in chapter 7 bankruptcy or the state law equivalent, (2) continuing the pension fund will prevent its successful reorganization under chapter 11, (3) the plan sponsor will not be able to pay its debts as they come due if it continues to fund the plan, or (4) the plan must be terminated to avoid an “unreasonably burdensome” pension cost. 29 U.S.C. § 1341(c)(1)(A).
- The PBGC may institute an involuntary termination whenever it determines that: (1) the plan sponsor has not met minimum funding standards; (2) the plan will not be able to pay benefits when due; (3) certain distributions are made by the pension plan to substantial owners of the plan sponsor or (4) the potential long-term loss to the PBGC may reasonably be expected to increase unreasonably if the plan is not terminated. 29 U.S.C. § 1342(a). PBGC must terminate a pension plan if the plan does not have assets available to pay benefits which are currently due.

D. Statutory PBGC Liens - Controlled Group Liability (26 U.S.C. § 430(k)(6)(c); 26 U.S.C. § 414(b) and (c))

- Both statutory liens are against all assets (both personal and real property) of the plan sponsor and members of its “Controlled Group.”
- Typically, the “Controlled Group” includes the plan sponsor and all chains of 80% owned subsidiaries (whether directly or indirectly owned); it would also include any 80% parent, and any other chains of 80% owned subsidiaries of the common parent.
- More controversial is whether the following are included in the sponsor’s “Controlled Group”:
  - (a) private equity funds (PBGC Appeals Board ruling that private equity fund is included in Controlled Group).  
*http://www.pbgc.gov/apbletters/Decision--(Liability within a group of companies) 2007-09-26.pdf).*

(b) non-profits (recent IRS regulations could bring related non-profit entities within the scope of the Controlled Group) 26 C.F.R. § 1.414(c)-5.

#### E. Statutory Scheme – Notice and Perfection of PBGC Liens

- Although the statutory lien arises as of a specific date (e.g., the date of the missed mandatory minimum contribution or the date of termination of the plan), the statutory lien is not effective against other secured interests until a notice of the lien has been filed in the appropriate recording office.
- Once filed in the appropriate recording office, notice is sufficient. PBGC need not (but may elect to) provide notice to the plan sponsor, other Controlled Group members and secured parties.
- Notice of the PBGC's statutory liens is required to be filed in a manner similar to the way the IRS files federal tax liens pursuant to IRC § 6323. The statute of limitations for enforcement of a PBGC lien is 6 years, rather than the 10 year period granted to the IRS. 29 U.S.C. § 1368(d).
- With respect to personal property, only one filing is necessary in the state where the principal executive office is located. The IRS has ruled that a corporation's principal executive office is the location where major executive decisions are made. It is not necessarily the location of the corporation's principal office. It is not necessarily the registered office or the statutory residence, nor is it the office for purposes of filing tax returns. Rev. Rul. 74-751.
- If a state fails to designate a location, the IRC states that the appropriate location for personal property filings is the office of the clerk of the federal district court in the district in which the personal property is located. 26 U.S.C. § 6323(f)(1)(B). (*See In re Plymouth Rubber Company*, Case No. 05-16088 (Bankr. D. Mass 2005)).
- With respect to real property liens, the IRC provisions require PBGC to file its liens in the county in which the real property is located. 26 U.S.C. § 6323(f)(1)(A).
- With respect to foreign entities, the IRC provisions require PBGC to file its liens with the Recorder of Deeds of the District of Columbia. 26 U.S.C. § 6323(f)(1)(C).

#### F. Statutory Scheme – Priority of PBGC Lien

- Upon filing, the priority of the PBGC statutory lien is similar to the treatment of properly perfected judgment liens under the Uniform Commercial Code. 26 U.S.C. § 6323.

- The PBGC statutory lien does not interfere with the priority of properly perfected liens securing obligations that predate the filing of notice of the PBGC statutory lien.
- The PBGC statutory lien will have priority over any credit extended and any collateral acquired by the borrower after the filing of the notice of the PBGC statutory lien (subject to certain exceptions). Therefore, the PBGC statutory lien may prime a secured lender's lien if it secures advances made after the filing of the PBGC lien. For example, upon perfection, PBGC may have priority over a secured lender's competing lien in inventory and accounts receivable. *See U.S. v. McDermott*, 507 U.S. 447 (1993) (holding that the filing of notice of federal lien renders the lien "first in time" for priority purposes).
- However, secured lenders are provided a grace period under 29 U.S.C. § 6323(d). The secured lenders' lien is not primed by PBGC's filing for a 45 day window, although such window expires earlier if the secured lender had "actual notice or knowledge" of the PBGC statutory lien. *See* 26 U.S.C. § 6323(i).

#### G. Enforcement Powers of PBGC

- On behalf of the pension plan, the PBGC may bring an action under ERISA in the applicable federal district court to enforce a statutory funding lien. 26 U.S.C. § 430(k)(5); *PBGC v. Mid-States Express, Inc. et al.*, Case No. 08-4208 (N.D. Ill. 2008); *PBGC v. LV Ventures, Inc.*, Case No. 08-2699 (N.D. Ill. 2008).
- The PBGC funding lien is not the exclusive method for PBGC to enforce liability for missed contributions. PBGC could seek to collect unpaid contributions on behalf of the plan by filing suit where the conditions for a lien are met. 29 U.S.C. § 1303(e).
- PBGC may file suit to collect termination liability whether or not the conditions for a lien are met. *See PBGC v. Carter & Tillery*, 113 F.3d 1183 (9<sup>th</sup> Cir. 1998).
- The PBGC may remove to the applicable federal district court a competing creditor's state court action to foreclose on property subject to the PBGC statutory lien. 29 U.S.C. § 1303(f)(7); *Koken (Reliance Insurance) v. Pension Benefit Guaranty Corporation*, Case No. 04-4342 (E.D. Pa. 2005).
- The PBGC statutory lien is enforced in the same manner as a lien held by the IRS. The applicable statutes contain little substantive or procedural detail as to the enforcement of a PBGC lien.

## H. PBGC Consensual Liens

- If a sponsor cannot meet the minimum funding requirement for a plan year because of “temporary business hardship” and application of the funding standard would be “adverse to the interests of plan participants in the aggregate,” the IRS may grant a waiver of all or a portion of the minimum funding requirement for that year. 26 U.S.C. § 412(c)(1). Such a waiver involves a deferral of payments otherwise due, and is usually accompanied by security or other protections.
- Such IRS waivers may only be granted in three of any fifteen consecutive plan years. 26 U.S.C. § 412(c)(1).
- The IRS often involves PBGC in negotiations on what collateral would be adequate to secure the deferred payments.
- Such liens are defined by the terms of the agreement and in that way are comparable to liens granted to a secured party. Such liens do not have the priming power of PBGC statutory liens.

## III. RISK MANAGEMENT FOR SECURED LENDERS

### A. Beware of Controlled Group Liability

- Evaluate borrowers’ ownership structure to determine whether non-borrowers who sponsor plans are in borrowers’ Controlled Group.

### B. More lien searches in more places

- Pay even closer attention to the type and location of borrower’s assets.
- Regular multi-state searches based on location of borrower’s assets.

### C. Keep up to date on financial statement disclosures on pension funding status post FASB Statement No. 158

- FASB Statement No. 158’s reporting requirements were in full effect as of December 15, 2008. Plan sponsors are required to record on their balance sheets (rather than in the footnotes to their financial statements) the funded status of their defined benefit plans. Overfunded or underfunded plans will result in the recognition of an asset or liability, respectively, on the sponsor’s balance sheet.

- FASB Statement No. 158 carries potential risks for secured lenders. As previously discussed, a PBGC statutory lien may prime a secured lender's lien securing advances made after the filing of the PBGC statutory lien. IRC section 6323(c)(4)(d) provides a 45 day safe harbor from the time of the PBGC filing of the statutory lien, but that window expires earlier if the secured lender had "actual notice or knowledge" of the PBGC lien. FASB Statement No. 158 could arguably be sufficient to provide "actual notice or knowledge" under IRC § 6323(i). The latter provision defines "actual notice or knowledge" of a lien filing as arising "from the time such fact is brought to the attention of the individual conducting such transaction, and in any event from the time such fact would have been brought to such individual's attention if the organization had exercised due diligence." IRC § 6323(i).
- *See also* Michael S. Terrien & Brian I. Swett, *Pension Protection Act, New FASB Rule May Put Secured Lenders at Greater Risk of PBGC Liens*, ABI Journal, Vol. XXV, No. 10 (Dec./ Jan. 2007).

#### IV. BANKRUPTCY ISSUES

##### A. Automatic Stay

- The Automatic Stay prevents creation, perfection or enforcement of a lien upon the filing of the bankruptcy petition. 11 U.S.C. § 362(a)(4).
- Courts have typically held that the automatic stay prevents the creation and/or perfection of PBGC's statutory liens on the debtors' estate post-petition. *See, e.g., PBGC v. Belfance (In re CSC Industries)*, 232 F.3d 505, 510 (6th Cir. 2000) (holding that the automatic stay prevented funding lien from arising post-petition); *PBGC v. Skeen (In re Bayly Corp.)*, 163 F.3d 1205, 1207 (10th Cir. 1998) (holding that automatic stay prevented termination lien from arising post-petition); *LTV Corp. v. PBGC (In re Chateaugay Corp.)*, 115 B.R. 760, 778-782 (Bankr. S.D.N.Y. 1990), *vacated on other grounds*, 1993 WL 388809 (S.D.N.Y. 1993).
- The automatic stay does not apply to non-debtor members of the sponsor's Controlled Group.

##### B. Avoidance of Statutory Liens

- The Bankruptcy Code generally provides that the debtor obtains the hypothetical rights of a judicial lien creditor as of the petition date. (11 U.S.C. § 544(a)). Typically, the debtor may avoid any unperfected lien, as such a lien would usually be voidable by a judicial lien creditor under non-bankruptcy law.

- With respect to statutory liens, Section 545 of the Bankruptcy Code controls the debtor’s avoidance powers. *See* 11 U.S.C. § 545; *see also* 11 U.S.C. § 547(c)(6) (referencing § 545). Typically, Section 545 is interpreted similarly to Section 544; in other words, the debtor may avoid an unperfected (un-filed) statutory lien that arose prior to the petition date.
- Some debtors have argued that Section 545 should be interpreted to allow debtor’s to avoid pre-petition *perfected* federal tax liens by asserting that the use of the term “purchaser” in Section 545 should be interpreted in light of the applicable federal law under which the federal tax lien is perfected—IRC section 6323(h)(6). That section defines a “purchaser” as follows: “a person who, for adequate and full consideration in money or money’s worth, acquires an interest . . . in property which is valid under local law against subsequent purchasers without actual notice.” If the Tax Code’s definition of “purchaser” was applied to the debtor-in-possession, it would arguably allow for the debtor to avoid a perfected (filed) pre-petition tax lien.
- In response, Congress amended Section 545(2) as part of the BAPCPA, effective October 2005. Amended Section 545(2) provides that the debtor “may avoid the fixing of a statutory lien on property of the debtor to the extent that such lien—(2) is not perfected or enforceable [on the petition date] against a bona fide purchaser . . ., whether or not such purchaser exists, except in any case in which a purchaser is a purchaser described in section 6323 of the Internal Revenue Code . . . .”
- Although the amendment’s language is not the clearest, presumably Congress intended to prevent debtors from avoiding perfected federal tax liens, including PBGC statutory liens.

### C. Adequate Protection

- To the extent PBGC liens both arose and were perfected pre-petition, PBGC will be treated as a secured lender in bankruptcy proceedings.
- Arguably, the automatic stay prevents PBGC from foreclosing on the collateral subject to its liens. The debtor, however, may not either (i) sell or lease assets subject to PBGC’s lien, or (ii) grant a priming lien on property subject to PBGC’s properly perfected lien (whether in the context of DIP financing or a motion for use of cash collateral) without providing PBGC adequate protection. 11 U.S.C. § 363(e); 11 U.S.C. § 364.
- Adequate protection is mandated only with respect to the value of the property subject to PBGC’s lien. 11 U.S.C. § 506.
- Adequate protection is a fact specific inquiry into the value of the collateral subject to PBGC liens. The inquiry is further complicated when PBGC liens are junior or subordinate and when assets subject to PBGC liens are at risk of diminishing value.

- PBGC may seek to lift the automatic stay to foreclose on its collateral if adequate protection is not provided. 11 U.S.C. § 362(d).
- *In re Northwest Airlines Corporation*, Case No. 05-17930 (Bankr. S.D.N.Y.); *In re Plymouth Rubber Company*, Case No. 05-16088 (Bankr. D. Mass); *In re A. Wimpfheimer Co.*, Case No. 08-32291 (E.D. Va. 2008).

#### D. 363 Sales/ Controlled Group Liability

- A debtor may sell its *assets* free and clear of liens, encumbrances, and interests under section 363. Such liens, encumbrances, and interests attach to the proceeds of the sale, and the holders thereof may not pursue any claims against the debtor or the purchaser. 11 U.S.C. § 363(f).
- There is room for debate on whether a debtor can consummate a section 363 sale of *non-debtor* subsidiaries free and clear of pension plan liens held by the PBGC, when such liens are enforceable against the *non-debtors* as members of the Controlled Group.

(a) When selling the *assets* of such a non-debtor subsidiary and attempting to upstream the proceeds from such sale, the debtor arguably should *first* have to satisfy the pension plan liens and claims from the sale proceeds or otherwise provide adequate assurance to the PBGC.

(b) When selling the *stock* of such a non-debtor subsidiary as part of a 363 sale, the pension plan liens arguably are not extinguished. *See Amphenol Corp. v. Shandler (In re Insilco Technologies, Inc.)*, Adv. Proc. No. 05-52403 (Bankr. D. Del. Sept. 18, 2006) (the sale of stock of a subsidiary under Section 363 is not free and clear of claims or interests against its assets) (preference liability context); *see also* Carol A. Jones, Fletcher Cyclopedia of the Law of Corporations § 29, at 70 (rev. ed. 2006) (“While a sale of stock changes the makeup of equity owners of a corporation, and therefore, it does not change the legal existence of the corporation, and therefore, a sale of stock cannot extinguish the obligations of the corporation.”).

(c) When selling a *foreign* non-debtor subsidiary’s *assets or stock* and attempting to upstream the proceeds from such sale, the debate over the appropriate treatment of pension plan liens often becomes particularly heated. The international application of Controlled Group liability under ERISA is largely untested. Hurdles to the PBGC’s ability to enforce the lien include establishing personal jurisdiction over the foreign non-debtor and convincing domestic, of if necessary, foreign courts of the extraterritorial reach of ERISA.

- *In re Delphi Corporation* Case No. 05-44481 (Bankr. S.D.N.Y. 2005); *In re Innovative Communications Corp.*, Case No. 07-30012 (Bankr. D. V.I. 2007); *New York Racing Association*, Case No. 06-12168 (Bankr. S.D.N.Y. 2006).

- *See also* Allan E. Reznick & A. Owen Glist, *Pension Benefit Guaranty Corp.-Controlled Group Claims Abroad*, New York Law Journal, Vol. 235-No. 33 (Feb. 17, 2006).