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Legislative Update

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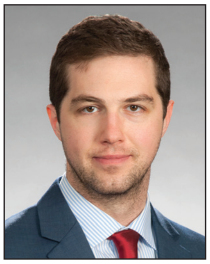
The COVID-19 Stimulus Bill and Pension Liability

A Lifeline for Underfunded Multiemployer Pension Plans



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On March 11, 2021, President Joe Biden signed the American Rescue Plan Act of 2021 (ARPA) into law,[2] which includes an appropriation package designed to shore up the nation's severely underfunded multiemployer pension plans through one-time grants intended to cover pension obligations through 2051. By recapitalizing the most distressed pension funds, the ARPA could improve the balance sheets of contributing employers who have contended with looming pension liabilities for years. While some details of the bill remain subject to the regulatory discretion of the Pension Benefit Guaranty Corp. (PBGC), there is little doubt that its implementation will alter the restructuring playing field for years to come.

Troubled Multiemployer Pension Plans: Bankruptcy Behemoths

Millions of Americans depend on multiemployer pension plans to provide fixed income to support them in retirement. First authorized in the 1970s, a multiemployer pension plan is created through an agreement between a union and two or more employers in the same or related industries. By pooling employee contributions from multiple companies, the plan is theoretically hedged against the financial distress of any one participating employer. On the other side of the coin, however, are the growing obligations to an aging workforce and the potential for massive funding shortfalls. Once popular and financially stable, the fortunes of multiemployer plans have declined in the 21st century due to a number of societal and political forces that have disrupted the unionized industries (*e.g.*, transportation, mining and manufacturing) where these plans are most prevalent.

When assessing the financial stability of a multiemployer plan, actuarial accountants focus on two metrics: funding ratio and active-participation ratio. The funding ratio is the ratio of current assets to the present value of obligations due to beneficiaries over time given certain actuarial assumptions (*i.e.*, the ability of the plan to satisfy its present obligations over time). The active-participation ratio is the ratio of active participants (employees for whom employers are paying regular contributions in respect of work performed) to inactive participants (to whom benefits are due).

One would expect a multiemployer plan supported by a profitable, heavily unionized industry to have a high active-participation ratio. High active participation generates new contributions with respect to the work performed, which can cover plan funding shortfalls. However, business sectors in decline have low participation ratios and must rely more heavily on their funding ratios to remain solvent. For this reason, traumatic market events (such as the March 2020 COVID-related market dip) cause disproportionate harm to troubled plans, even if the market rebounds relatively quickly. Moreover, plans are often required to invest plan assets in relatively safe stores of value such as U.S. Treasurys and highly rated bonds. When interest rates are low, as they have been since the Great Recession of 2008, the yields on these assets can fall below anticipated returns.

Long ago, Congress created a backstop to pension plan insolvency: the federally chartered PBGC, which charges annual premiums to private pension plans. When a plan becomes insolvent, the PBGC

1 The opinions expressed in this article are not necessarily the opinions of Brown Rudnick LLP or its Restructuring Group.
2 H.R. Res. 1319, 117th Cong. (2021) (enacted).

assumes control of its remaining assets and benefits obligations. Moreover, the PBGC is permitted by law to regulate aspects of plan governance and the calculation and reporting of benefits obligations. However, the PBGC's insurance pool for multiemployer plans was, until recently, insufficiently funded, leaving millions of American incomes in danger.

Bankruptcy practitioners recognize multiemployer pension plans as frequent and powerful players on the creditor side in some of the nation's largest chapter 11 cases. If an employer withdraws from participating in a multiemployer pension plan, it may incur significant liability in the form of the withdrawing employer's proportionate share of the plan's funding shortfall (the "withdrawal liability"). If the pension plan is financially distressed, the departing employer's share of the funding shortfall might be millions of dollars *per employee*, dwarfing the liabilities of its other unsecured creditors and diluting their recoveries.[3]

The size of potential withdrawal liability — and its potential extension to corporate owners, affiliates and successors[4] — impacts many facets of restructuring practice beyond claims resolution and litigation. Withdrawal liability concerns may drive, among other aspects of a case, (1) whether the company is a viable target for a merger or acquisition by an equity sponsor outside of chapter 11; (2) an employer's decision to commence proceedings in a particular jurisdiction;[5] (3) whether modifications to collective-bargaining agreements and retiree-benefit obligations that would allow the employer to remain in the plan are feasible and palatable;[6] (4) an employer's decision to attempt a standalone restructuring vs. a § 363 all-asset sale and liquidation plan;[7] and (5) creditor negotiations and support for restructuring plans.[8] The disproportionate impact of withdrawal liability over so many critical decisions ensures that any change to the pension-liability landscape will likewise cascade over corporate decision-making not only in chapter 11, but in the negotiation of workouts and labor agreements.

Congress Rescues Critical and Declining Multiemployer Plans

The key feature of the ARPA's pension component is to backstop the solvency of the most endangered plans and provide PBGC regulatory authority over financial assistance and related measures.[9] The bill thus also preserves the PBGC for decades to come.

To that end, the ARPA authorizes the Treasury to allocate "such amounts as are necessary" to create a Special Financial Assistance Fund to ensure that qualifying plans are able to pay all benefits and reinstate suspended benefits through 2051.[10] Qualifying plans will have until Dec. 31, 2025, to apply for assistance from the fund. A multiemployer plan qualifies for special assistance if it meets one of four criteria, generally including insolvent plans and "critical and declining" plans as defined by law.[11]

The ARPA's interpretation and implementation in the coming months will set the stage for corporate restructuring and labor-relations activity for many years to come.

While the PBGC is given discretion to issue regulations regarding application requirements and regulations concerning asset allocation and benefits reductions, and can delay the submission of applications in some circumstances, it is constrained in its ability to deny or propose changes to any application from an eligible plan. Plans are permitted to determine the amount of financial assistance due using their own actuarial assumptions and continue in self-governance. The PBGC will accept these assumptions unless they are "clearly erroneous."[12] Applications for assistance shall be deemed approved, unless the PBGC notifies the plan within 120 days that its application is incomplete, its assumptions unreasonable, or that it is ineligible for relief.[13]

Restructuring Implications

The ARPA's Special Financial Assistance Fund provides an indirect benefit to the employers who participate in the plan and may themselves be experiencing distress as a result of the pandemic and declining plan participation

3 The same is true, to a great extent, of single-employer pension plans. When a company that sponsors a single-employer plan becomes insolvent, it may seek to terminate the plan, incurring "termination liability," which is calculated and imposed analogously to withdrawal liability.

4 The Employee Retirement Income Security Act (ERISA) imposes joint and several liability on each "trade or business" that is under "common control" with the withdrawing employer by virtue of an 80 percent ownership stake or greater. *See* 29 U.S.C. § 1301(b)(1) (referencing 26 C.F.R. § 1.414(c)-2(a) and (b)(2)(1)). This liability is known as "controlled group" liability, in reference to the defined term in the Tax Code concerning common control. *See also* David A. Mawhinney & Tristan G. Axelrod, "What *Sun Capital* Can Teach About Controlled Group Liability and Pension Fund Fights to Come," XXXIX *ABI Journal* 9, 26-27, 70-71, September 2020, *available at* abi.org/abi-journal (describing developments in legal standard for imposition of controlled-group liability; unless otherwise specified, all links in this article were last visited on March 26, 2021). Controlled-group liability incentivizes pension plans to litigate against numerous chapter 11 stakeholders to maximize collection where owners and/or purchasers do not intend to carry on operations and contribute to the pension going forward.

5 This is because jurisdictions vary in standards for imposition of controlled-group liability on the employer's owners and affiliates. *See In re Alpha Natural Res. Inc.*, 552 B.R. 314, 332-33 (Bankr. E.D. Va. 2016) (describing jurisdictional differences); *In re Walter Energy Inc.*, 542 B.R. 859, 899 (Bankr. N.D. Ala. 2015) (same).

6 Pension participation is often, if not always, tied to collective bargaining. Sections 1113 and 1114 of the Bankruptcy Code provide special protections to collective-bargaining agreements and retiree benefits that require the reorganizing chapter 11 debtor to propose modifications to these entitlements before it will be permitted to reject them. Notwithstanding these protections, however, collective-bargaining agreements can generally be terminated where the insolvent employer's assets are auctioned and no bidder offers to assume the agreements and related pension obligations. *See, e.g., In re Alpha Natural Res. Inc.*, 552 B.R. 314 (Bankr. E.D. Va. 2016) (describing labor force and benefit cuts resulting from coal industry decline); *In re Walter Energy Inc.*, 542 B.R. 859, 899 (Bankr. N.D. Ala. 2015) (describing sale process and impossibility of buyer assuming obligations); *see generally* Mary Williams Walsh, "Congress Saves Coal Miner Pensions, but What About Others?" *N.Y. Times* (Dec. 24, 2019), *available at* nytimes.com/2019/12/24/business/coal-miner-pensions-bailout.html (describing "parade" of coal bankruptcies resulting in near-mass pension withdrawal).

7 For example, an employer not facing significant pension liability might be more likely to attempt standalone reorganization and maintain pre-petition ownership and control rather than conduct a sale that cuts off pension liability but also subjects the company's assets to competitive bidding.

8 Because withdrawal liability is unsecured and frequently larger than other combined outstanding unsecured indebtedness, pension funds may have blocking positions in voting on any plan requiring support from the unsecured class. Likewise, a plan under which a successor assumes pension liability provides significant benefits to unsecured creditors that may allow the debtor to secure votes while reducing plan distributions and other benefits to less favored stakeholders.

9 In addition, the ARPA temporarily suspends the requirement that the plan actuary certify whether the plan is in endangered, critical, or critical and declining status (§ 9701); extends the time periods for endangered and critical-status plans to complete their improvement and rehabilitation plans (§ 9702); and allows the plan actuary to exclude from the plan solvency analysis plan losses related to the COVID-19 pandemic (§ 9703).

10 ARPA § 9704. Mainstream reporting estimates the capitalization requirement of this fund at $86 billion based on federal government accounting of qualifying plans. The true cost will be apparent only following issuance of the PBGC guidance and submission and acceptance of assistance applications by qualifying plans.

11 *See* ARPA § 9704(b) (providing financial assistance to plans by creating new § 4262 of ERISA, 29 U.S.C. § 1432). The definition of "critical and declining" status is found at § 305 of ERISA (29 U.S.C. § 1085). Very generally, a plan is "critical and declining" if its funding ratio is below 65 percent and it is projected to become insolvent within a period of 14-19 years, calculated based on its active participation and funding ratii. The ARPA also permits special financial assistance to plans funded below 40 percent with an active participation ratio below 2:3, and plans that have been permitted to suspend benefits to avoid insolvency under a 2014 law.

12 ARPA § 9704(e)(1).

13 ARPA § 9704(g).

over the previous two decades. While the Special Financial Assistance Fund cannot solve macroeconomic and operational problems, by right-sizing pension plan obligations, it may give these businesses a chance to reorganize through traditional balance-sheet restructuring, raising new capital or acquiring strategic partners through merger-and-acquisition transactions. One CEO of a recent chapter 11 debtor with massive pension obligations has publicly observed that had the ARPA been passed a year earlier, chapter 11 restructuring likely would have been avoided.[14]

By recapitalizing multiemployer pension plans, the Special Financial Assistance Fund could effectively reduce employer liabilities to the plans, thereby potentially revitalizing whole industries. This approach is somewhat analogous to the Federal Deposit Insurance Corp.'s "single-point-of-entry" initiative for resolving the failure of large financial conglomerates.[15] If successful in reducing liabilities and discouraging plan withdrawal, the Special Financial Assistance Fund could not only protect the PBGC and American retirees, it could encourage value-accretive investment in unionized industries such as commercial transport.

The PBGC will issue regulatory guidance by July 9, 2021, which will govern critical aspects of the ARPA implementation. Crucially for bankruptcy practitioners and some employers, the ARPA permits the PBGC to impose "reasonable conditions" on multiemployer plans relating to withdrawal liability, although the meaning of this language is not clear. An early draft of the bill would have carved out Special Financial Assistance Funds from a departing employer's withdrawal liability calculation for a 15-year period, a measure that was probably intended to discourage opportunistic employer withdrawals at the perceived moment of maximum solvency after receipt of assistance.

In addition, bankruptcy lawyers should recall the approach taken by the Small Business Administration in administering the Paycheck Protection Program, which was to deny chapter 11 debtors access to those loans. Similarly, neither multiemployer plans nor the PBGC will be incentivized to decrease withdrawal liability assessments where the liability has already been determined and factored into a debtor's reorganization strategy.

The PBGC will be tasked with determining exactly how to calculate the amounts of assistance due through its rulemaking; the ARPA gives it discretion within a vast range. On the one hand, the PBGC could ensure funding of all payments through 2051 and allow plans to become insolvent immediately thereafter; on the other, it could actually fund all payments through 2051 entirely from the Special Financial Assistance Fund, and allow the plans' current assets to compound for 30 years and fund benefits for decades thereafter.

The ARPA's interpretation and implementation in the coming months will set the stage for corporate restructuring and labor-relations activity for many years to come. Insolvency professionals and strategic advisors working with plans, multiemployer plan contributors and controlled group members should carefully review the forthcoming PBGC guidelines, as well as the timeline for subject plans to actually receive financial assistance lump-sum payments. abi

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14 Craig Forman, "COVID Relief Bill Throws Lifeline to Transform Local News," *Nieman Reports* (March 10, 2021), *available at* niemanreports.org/articles/covid-relief-bill-throws-lifeline-to-transform-local-news. Mr. Forman was the CEO of McClatchy Co., Case No. 20-10418 (Bankr. S.D.N.Y.). The ARPA provides certain reforms specific to community newspapers that decrease mandatory minimum funding payments that burdened McClatchy's single-employer plan. *See id.*; ARPA § 9707.

15 *See* Fed. Dep. Ins. Co., Resolution of Systemically Important Financial Institutions: The Single Point of Entry Strategy, 78 C.F.R. 243, p. 76614 (Dec. 18, 2013).