Pension Plan Terminations and Asset Reversions: Accommodating the Interests of Employers and Employees

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Plan sponsors have terminated more than five hundred overfunded pension plans from 1979 to 1985. These terminations represent approximately four billion dollars in total asset reversions to employers. In recent years, many pension funds became overfunded by growing well beyond the value needed to satisfy current liabilities. High interest rates and higher than expected investment yields caused this growth. As a result, these burgeoning pension funds became attractive sources of cash and venture capital to their sponsors. Without any means to reach

1. For a discussion of what constitutes plan termination, see infra notes 70-80 and accompanying text.


Discussion of restrictions on disposition of excess assets under collective bargaining agreements is beyond the scope of this Note. For a case discussing the employer's ability to recapture excess assets from a collectively bargained pension plan, see Washington-Baltimore Newspaper Guild Local 35 v. Washington Star Co., 555 F. Supp. 257 (D.D.C. 1983) (upholding an employer's right to recapture excess assets resulting from actuarial error), aff'd mem., 729 F.2d 863 (D.C. Cir. 1984).

4. If the Pension Benefit Guaranty Corporation (PBGC) grants currently pending applications for plan terminations, this total could increase by another $2 billion. Roybal, supra note 2, at E2615.


6. These excess funds have been used for a range of corporate activities, including payment of merger and acquisition debts, purchasing company stock to prevent unfriendly takeover attempts, and improving financial balance sheets to help attract new capital. See Louis, Tapping the Riches in Company Pension Plans, Fortune, Dec. 26,
these excess funds, several companies amended their pension plan provisions to allow for recapture of excess assets in the event of plan termination.7

Generally, terminations are of defined benefit pension plans8 that guarantee participants9 a predetermined level of benefits upon retirement, unless the plan is terminated prior to participants' retirement. When such a plan becomes overfunded and is terminated, the plan sponsor10 satisfies accrued liabilities as of the termination date and recaptures the excess funds that could have otherwise accrued as some form of future benefits to plan participants.11 Consequently, the retirement income security of

1983, at 129. Companies may have become more aware of these surplus assets as a result of a new disclosure requirement of the Financial Accounting Standards Board that requires employers to include the value of pension plan assets and accrued liabilities in their financial statements. See Grubbs, Termination of Pension Plans with Asset Reversion: A Solution, J. PENSION PLAN. & COMPLIANCE, June 1984, at 199, 201.

7. Generally, courts have upheld the right of employers to amend their pension plans to allow asset reversion upon termination. See, e.g., Audio Fidelity Corp. v. PBGC, 624 F.2d 513 (4th Cir. 1980) (holding a post-termination amendment improper and thus invalid); In re C.D. Moyer Co. Trust Fund, 441 F. Supp. 1128 (E.D. Pa. 1977) (allowing a plan amendment prior to termination that provided for reversion of surplus assets), aff'd mem., 582 F.2d 1273 (3d Cir. 1978).

8. For a definition of defined benefit plans, see ERISA § 3(2), (35), 29 U.S.C. § 1002(2), (35) (1982). See also In re Gray-Grimes Tool Co., Inc. Pension Plan, 546 F. Supp. 102, 107 (E.D. Mich. 1982) (holding that defined benefit plans may also include plans that promise benefits based on years of service and earnings and that are not fixed and based on amount contributed).

9. ERISA defines "participant" as:
any employee or former employee of an employer, or any member or former member of an employee organization, who is or may become eligible to receive a benefit of any type from an employee benefit plan which covers employees of such employer or members of such organization, or whose beneficiaries may be eligible to receive any such benefit.

10. ERISA defines "plan sponsor" as:
(i) the employer in the case of an employee benefit plan established or maintained by a single employer,
(ii) the employee organization in the case of a plan established or maintained by an employee organization, or
(iii) in the case of a plan established or maintained by two or more employers or jointly by one or more employers and one or more employee organizations, the association, committee, joint board of trustees, or other similar group of representatives of the parties who establish or maintain the plan.

11. For instance, these assets might have been used to fund cost-of-living adjustments to retiree benefits. Also, these excess assets, sometimes called "experience gains," could have offset the inevitable "experience losses" that occur during poor market conditions. In fact, the primary reason the Internal Revenue Code prohibits the withdrawal of these excess funds from an active plan is that there must be a cushion of assets to protect the plan from cyclical market behavior. See 26 U.S.C. § 401(a)(2) (1982); Treas. Reg. § 1.401-2 (1980). See also R. LYNN, THE PENSION CRISIS 157 (1983).
Plan participants is diminished when these overfunded plans are terminated before benefits have fully accrued. After termination, however, some employers institute successor plans or purchase annuity contracts, thereby ensuring a continuation of coverage for participants under the former plan. Nonetheless, these post-termination arrangements often do not adequately compensate plan participants and their beneficiaries for the loss of anticipated benefits suffered through termination and asset reversion.

The potential adverse impact of plan termination upon the retirement income security of plan participants and their beneficiaries is arguably justified when a clear financial or business necessity exists. The detrimental effect of a plant closing can be far more severe than a pension plan termination. Thus, allowance of a plan termination to avoid the loss of numerous jobs is reasonably justified.

Termination of an overfunded plan and recapture of excess assets for a reason other than saving a failing company, however, raises serious issues. The ease with which companies have been able to terminate overfunded pension plans has generated concern among both legislators and regulators for the retirement income security of terminated plans' participants. In addition, some of the various termination methods raise the question of whether a true termination has indeed occurred. Moreover,

12. See Donlan, Hands in the Cookie Jar: Why Companies are Tapping Their Pension Funds, BARRON'S, May 21, 1984, at 8; Louis, supra note 6; O'Donnell, Pension Funds as Profit Centers, FORBES, May 7, 1984, at 35.

13. Many employers are concerned about negative employee reaction to an outright plan termination, and thus seek to quell such reaction by instituting minimally funded successor plans and continuing the same level of retirement coverage. Generally, employees are not even aware of these paper transactions. See Donlan, supra note 12.

14. To guarantee future retirement benefits, recent PBGC guidelines require plan sponsors to purchase and distribute annuity contracts to plan participants when plans are terminated. See infra note 38.

15. See infra text accompanying notes 46-64. Cash-out arrangements with lump-sum distributions are the major sources of inadequate compensation for former plan participants. 26 U.S.C.A. § 411(a)(7)(B) (West Supp. 1985) allows a plan to involuntarily cash out the benefit (i.e., pay out the balance of a participant's account to him without his consent) if the present value of the benefit does not exceed $3,500.

16. Although no such test exists under current law, proposed legislation pending in Congress would establish a business necessity test. See infra text accompanying notes 95-96.

17. The spinoff and reestablishment termination methods are methods that raise the most serious doubts about whether a true termination has occurred. The spinoff termination method essentially splits the current plan into two plans: one for active employees and one for retired employees. The excess assets are put into the retirees' plan, which is then terminated. The excess assets are recaptured upon termination of the retirees' plan. Under the termination reestablishment method, the current overfunded plan is termi-
whether the plan sponsor should be the beneficiary of a rise in the market value of plan assets raises a critical issue of fairness.\(^\text{18}\) Although the plan sponsor bears all the market risks and thus should theoretically benefit from a rise in asset values, the Employee Retirement Income Security Act\(^\text{19}\) (ERISA) declares that the plan assets are for the exclusive benefit of the participants.\(^\text{20}\) Despite these concerns, courts and regulatory agencies have generally upheld the validity of terminations and asset reversions under ERISA and the Internal Revenue Code (IRC).\(^\text{21}\)

When Congress enacted ERISA to protect the retirement income of American workers, it did not foresee the dramatic growth of overfunded pension plans, or the issues such plans would raise.\(^\text{22}\) Thus, it is imperative that Congress move swiftly to enact the necessary legislative reforms to bring about an equitable resolution of the issues overfunded plans raise. The Plan Termination and Reversion Control Act of 1985,\(^\text{23}\) a bill now pending in Congress, is a first step toward resolution of these issues that affect millions of American workers.

This Note focuses on the problems that often arise for plan participants when an overfunded defined benefit plan is terminated and the employer recaptures excess assets. Part I explains the relative ease with which employers can terminate plans and receive excess assets under current pension law. Part II argues

\(^1\text{8}\) Under current tax law, it is clear that when a pension surplus is due to actuarial error, the employer benefits from that error. An actuarial error occurs when actual funding requirements under the plan are different from projected funding requirements. See 26 C.F.R. § 1.401o-2(b)(1) (1985).


\(^2\text{0}\) See infra note 31.


As a historical note, in 1938 the Senate rejected, on grounds of fairness, a restriction on reversion of excess assets to employers. See S. REP. No. 1567, 75th Cong., 3d Sess. 24 (1938).


that pension law must be reformed because its shortcomings threaten American workers’ retirement income security, it allows for sham terminations that remove assets from plans that are, in fact, ongoing, and it usually allows excess assets to go to employers rather than employees. Part III discusses two reforms proposed for plan terminations and asset reversions, which are the Plan Termination and Reversion Control Act of 1985, and conditional employer withdrawals of assets from ongoing plans. Part III also highlights some of the strengths and weaknesses of these two policy options.

In keeping with ERISA’s original policy objectives, Congress should act now to reduce employer incentives to terminate overfunded pension plans. The security of private pension plans is threatened when employers terminate such plans for the express purpose of recovering excess assets that ultimately would have inured to the benefit of plan participants. The Plan Termination and Reversion Control Act of 1985 is a step in the right direction, but Congress should consider other viable options, such as allowing conditional employer withdrawals from active plans, that go further in accommodating the best interests of both employers and employees.

I. THE LAW GOVERNING TERMINATION OF PLANS AND ASSET DISTRIBUTION

In 1974 Congress enacted ERISA to improve and protect the retirement income of American workers. Inadequacies in state and federal laws, severe underfunding of some pension plans, and horrifying accounts of reasonable worker expectations of retirement benefits destroyed by abuse and mismanagement of plan assets led Congress to revamp the entire pension system. Congress made significant changes in the pension regulatory scheme as well as in funding, vesting requirements, and fiduciary standards. As a result of these changes, the private pension system has experienced significant growth in recent years and is healthier than ever before.

29. At the end of 1983, assets of private pension plans amounted to $900 billion and
ERISA clearly allows for voluntary plan termination. Plan termination triggers a specific exception to the exclusive benefit rule of ERISA, thus allowing the employer to utilize plan assets that otherwise would have benefited plan participants. In particular, the Act provides that any residual assets remaining after plan termination may be distributed to the employer if all current and contingent liabilities of the plan have been satisfied, the distribution does not violate any existing law, and the plan includes a provision allowing for such a distribution. If the residual assets are a result of actuarial error, however, the employer has an exclusive right to recapture them. After all liabilities are satisfied, if any of the residual assets are attributable to employee contributions they must be equitably distributed to the employees. Thus, it is clear that the employer and the employees each have only a qualified right to some portion of the excess assets of a terminated plan.

The Pension Benefit Guaranty Corporation (PBGC), the government insurance agency that protects plan participants' accrued benefits, has recently announced new guidelines that recognize the right of employers to recover excess assets upon termination if certain conditions are satisfied. These guidelines were expected to grow to $3 trillion by 1985. Moratorium on Pension Plan Reversions: Hearings on S. 2435 Before the Subcomm. on Labor of the Senate Comm. on Labor and Human Resources, 98th Cong., 2d Sess. 11, 14 (1984) (statement of Raymond Donovan, Secretary of Labor) [hereinafter cited as Hearings on S. 2435].

31. The exclusive benefit rule states: "[E]xcept as provided in paragraph (2), (3), or (4) or subsection (d) of this section, or under §§ 1342 [ERISA § 4042] and 1344 [ERISA § 4044] (relating to termination of insured plans) of this title, the assets of a plan shall never inure to the benefit of any employer . . . ." ERISA § 403(c)(1), 29 U.S.C. § 1103(c)(1) (1982).
35. See supra note 18.
38. The new PBGC guidelines regarding plan termination and recovery of excess assets provide that:

(1) All participants' benefits must be fully vested, and annuity contracts must be purchased for and distributed to plan participants.
(2) The amount of any lump-sum payments must fairly reflect the value of the pension to the individual.
(3) Termination re-establishment transactions are permitted, and the new plan may grant past service credit. The successor plan will be exempt from the five-year phase-in of PBGC benefit guarantees that apply to newly established plans.
set forth new funding requirements aimed at protecting minimum funding standards for plans established after the termination of a previously overfunded plan. Some critics, however; argue that these new funding requirements have no basis in current statutory law and thus are arguably unenforceable.

Moreover, the guidelines have been challenged for not explicitly addressing the issue of whether a termination has actually occurred when it spins off another plan or reestablishes a plan after a termination.

Another of the guidelines' flaws is that they do not mandate that a plan grant credit to plan participants for past service, but simply allow employers to grant such credit. The absence of past service credit in a successor plan could arguably result in a diminution in the amount of retirement benefits an employee otherwise would have earned under the terminated plan. In addition, the absence of past service credit in a successor plan might put the PBGC at a greater risk of having to save a plan that is only minimally funded in the event of a sharp decline in the market value of plan assets.

(4) Spinoff/terminations are permitted only if benefits of all employees are fully vested as of the date of termination, all accrued benefits in the ongoing plan are provided for by the purchase of annuity contracts, and employees are given advance notice of the transaction.

(5) An employer that terminates a plan under a spinoff/termination or termination/re-establishment transaction generally may not engage in either transaction again for 15 years.

(6) In spinoff/terminations, and termination/re-establishment transactions where credit is given for past service, amortization periods must be changed resulting in a change in funding method. These changes in funding method must be approved by the Service.

(7) The federal income tax consequences of the receipt of reversions, of deductions for contributions to ongoing or successor plans, and of the funding of such plans, after the change in funding method, are unchanged by these guidelines.

See Dankner, supra note 17, § 3.04, at 3-8, 3-9.


40. This is referred to as a spinoff termination. See Roybal, supra note 2, at E2616.

41. This is referred to as a reestablishment termination. Id.

42. Id.

Past service credit generally refers to the number of years of service an employee may have prior to the establishment of a plan. The employer may count those years for the purpose of determining vesting rights under the plan. D. DUNKLE, GUIDE TO PENSION AND PROFIT SHARING PLANS § 4.03, at 4-6 (1984).

43. This problem would be remedied by the Plan Termination and Reversion Control Act of 1985, H.R. 2701, supra note 23, which mandates the inclusion of past service credit from a previous plan into a successor plan. See Roybal, supra note 2, at E2615.

44. See Roybal, supra note 2, at E2616.
II. POLICY CONCERNS OF THE LAW GOVERNING PLAN TERMINATION AND ASSET DISTRIBUTION

The recent growth in plan terminations and asset reversions has raised three major policy concerns. First, terminations have threatened the retirement income security of many Americans. Second, under the guise of terminations employers have circumvented ERISA's prohibition against removing assets from ongoing plans. Third, terminations have raised the question of whether excess plan assets belong to employers or employees. In spite of the concerns termination practices raise, federal agencies charged with the responsibility of administering ERISA have upheld the validity of these practices.

A. Retirement Income Security

Plan terminations can place some employees in a less financially secure retirement position than they were before the termination. One way this can happen is by giving them lump-sum payments that do not accurately reflect the present value of their accrued benefits. District 65, UAW v. Harper & Row, Publishers, Inc. illustrates the financial harm lump-sum payments can cause employees whose pension plans are terminated. Harper & Row sought to finance a stock purchase, in part, by terminating its defined benefit plan. The company filed notice with the PBGC and submitted an application to the Internal Revenue Service (IRS) for a determination that the plan termination would not result in a loss of the plan's tax qualified status. Both the PBGC and the IRS granted approval for pro-

45. See supra note 31.
47. The financing plan for this stock purchase also included the sale of real property, the purchase of company stock by the employee profit-sharing plan, and loans. Id. at 1473.
48. ERISA requires that the employer file with the PBGC a Notice of Intent to terminate a defined benefit plan 10 days prior to the proposed termination date. After receiving this Notice of Intent, the PBGC issues a Notice of Sufficiency if it has approved the termination. ERISA § 4041(a), 29 U.S.C. § 1341(a) (1982). If the assets of a terminated plan are insufficient to satisfy accrued benefits, the PBGC satisfies those benefits. The employer, however, remains liable to the PBGC for up to 30% of the employer's net worth. See ERISA §§ 4001-4201, 29 U.S.C. §§ 1301-1381 (1982).
ceeding with the plan termination.\textsuperscript{50}

The company implemented a plan to meet the benefit needs of three different groups of employees after the termination.\textsuperscript{51} First, employees whose benefits had an accrued present value of less than $250 were required to accept a lump-sum payment.\textsuperscript{52} Second, employees whose benefits had an accrued present value of between $250 and $1,000 had the choice of receiving either a lump-sum payment or an annuity.\textsuperscript{53} Third, employees whose benefits had an accrued present value of more than $1,000 were required to accept an annuity.\textsuperscript{54} Under this arrangement the company recaptured approximately $9 million after the plan termination.\textsuperscript{55}

The court recognized the company's absolute right to terminate the plan\textsuperscript{56} and held that the decision to terminate the pension plan did not constitute a breach of any fiduciary duty under ERISA.\textsuperscript{57} The court, however, found merit in the plaintiff's argument that the distribution of excess assets upon termination was inequitable.\textsuperscript{58} In denying the company's motions for summary judgment, the court concluded that at least two issues of fact existed which suggested that the distribution of assets was unfair. First, the court agreed with the plaintiffs that the amount of information the company provided may not have been sufficient for them to make an informed choice about their benefit options.\textsuperscript{59} In particular, the company did not disclose that it used a fifteen percent interest rate assumption to value the lump-sum payments.\textsuperscript{60} If this disclosure had been made, some employees would have rejected the lump-sum payment in favor

\textsuperscript{50} 576 F. Supp. at 1473. The PBGC has discretionary power to restore a terminated plan to active status if it determines that reasonable actuarial assumptions were not used to value accrued benefits. ERISA § 4047; 29 U.S.C. § 1347 (1982). In Harper & Row plaintiffs filed individual complaints against the PBGC, alleging that the PBGC's Notice of Sufficiency was issued without a finding that the plan termination was based upon reasonable interest rate assumptions. 576 F. Supp. at 1484.

\textsuperscript{51} Upon termination of a plan, the employer can satisfy plan liabilities either through cash distributions equal to the present value of accrued benefits or through the purchase of annuity contracts from an insurance company thereby guaranteeing future retirement benefits. Rev. Rul. 83-52, 1983-1 I.R.B. 87.

\textsuperscript{52} 576 F. Supp. at 1479.

\textsuperscript{53} Id.

\textsuperscript{54} Id. The court decided that ERISA does not require an employer to purchase individual annuity contracts rather than group contracts as Harper & Row did.

\textsuperscript{55} 576 F. Supp at 1473-74.

\textsuperscript{56} Id. at 1476-77.

\textsuperscript{57} Id. at 1478.

\textsuperscript{58} Id. at 1479.

\textsuperscript{59} Id. at 1480.

\textsuperscript{60} Id.
of the annuity, because they would have thought the interest rate was too high and therefore gave them an unrealistically low present value for their retirement benefits.

Second, a question of fact existed regarding whether the fifteen percent interest rate assumption was reasonable in view of the economic conditions prevailing at the time. The plaintiffs contended that the company had used an artificially high interest rate assumption to reduce the present value of accrued benefits, and thus maximized the excess assets upon termination. Employees who received lump-sum payments ultimately realized that they could reasonably expect only about a seven percent return on those payments. Consequently, those employees could not enter the private market and buy annuity contracts equivalent to their accrued benefits under the terminated plan because of this unrealistic interest rate assumption.

As Harper & Row illustrates, plan terminations can place some employees in a less financially secure retirement position than they were before the termination. Employees who receive lump-sum payments may later realize that these payments do not accurately reflect the present value of their accrued benefits. In short, these employees cannot use their lump-sum payments to secure their future retirement income to the extent the terminated plan did.

The retirement income security of employees may also be impaired when defined benefit plans are replaced with defined contribution plans. With a defined contribution plan, employees are not guaranteed any fixed benefit upon retirement. Employer contributions, however, are fixed for the long term, and retirement benefits become a function of the sufficiency of these contributions and of market conditions. In essence, the defined contribution plan shifts market risks away from the employer and onto the employees.

Individual terminations affect the retirement income security

61. Id. The reasonableness standard for interest rate assumptions is set forth in 29 C.F.R. § 2619.26(c)(2) (1985).
63. For instance, an employee receiving a $700 lump-sum payment for his accrued benefit based on 12 years of service under the Harper & Row plan would have been required to pay approximately $7000 to purchase a life annuity at that time. See Roybal, supra note 2, at E2616.
64. Id.
65. For most major industries, defined benefit plans have been the rule and defined contribution plans the exception. Thus, a change from defined benefit to defined contribution plans is a significant one for employers in some industries. BUCK CONSULTANTS, FOR YOUR BENEFIT No. 79, UTILIZING “SURPLUS” PENSION PLAN ASSETS 3-4 (April 1984).
66. See Grubbs, supra note 6, at 200.
of individual employees, but the increase in the number of plan terminations is likely to diminish the security of the plan termination insurance system, thus affecting many more employees than those whose plans are terminated. The PBGC premium level is determined by the number of plan participants covered by private defined benefit plans, so it will increase as the number of such plans and participants decreases through terminations. Thus, if the number of terminations of overfunded and otherwise healthy pension plans continues rising, then the premium levels for continuing plans will be forced upward. Spiraling premium levels will divert some funds away from building plan assets, and thus ultimately reduce benefit levels for retirees. Moreover, high insurance premiums may make some employers reluctant to establish defined benefit plans.

The rise in plan terminations causes valid concern for the retirement income security of employees as well as the plan termination insurance system itself. It is imperative that Congress act to stem the tide of terminations through changes in pension law. These changes should reduce employer incentives for terminating overfunded pension plans, while accommodating employers who need excess plan assets for legitimate business necessities.

B. Spinoff and Reestablishment Terminations

An employer cannot withdraw assets from an ongoing plan, so determination of whether a plan termination has actually occurred can be important. Generally, whether a plan termination has occurred depends upon the facts and circumstances of each alleged termination. A decision about whether a termination has occurred is often difficult to make when an employer has used either the spinoff or reestablishment methods of termination. These methods essentially allow an employer to terminate partially the current plan, withdraw the excess assets, and continue a minimally funded successor plan purportedly

68. See Grubbs, supra note 6, at 202.
69. Id.
70. See supra note 31.
71. It is only through termination that an employer can reach excess assets for its own purposes. Thus, this is the exception to the exclusive benefit rule. Id.
72. See Treas. Reg. § 1.401-6(b) (1963).
73. See supra note 17.
74. Id.
comparable to the terminated plan.\textsuperscript{76} Thus, the question these transactions present is whether they exalt form over substance in violation of ERISA's prohibition against withdrawing assets from ongoing plans.\textsuperscript{76}

Initially, the IRS was concerned that the spinoff and reestablishment terminations were vehicles for avoiding the tax consequences of asset reversion following plan termination.\textsuperscript{77} No evidence, however, demonstrates that tax considerations play a major role in employers' plan termination decisions.\textsuperscript{78} Recently, the IRS has questioned whether novel termination methods are consistent with ERISA's minimum funding requirements.\textsuperscript{79} When excess assets have been withdrawn from a terminated pension plan and a minimally funded successor plan put in place, there is the risk that the absence of an asset cushion will cause the underfunding of accrued benefits. Despite these concerns, the recent PBGC guidelines legitimize spinoff and reestablishment terminations.\textsuperscript{80} Thus, current law allows employers to accomplish indirectly what they could not accomplish directly.

\textbf{C. Allocation of the Benefits from a Rise in the Market Value of Plan Assets}

When a pension plan becomes overfunded because of an unexpected rise in the market value of plan assets, generally the employer can reap the benefit of this excess value.\textsuperscript{81} Employers argue that they should realize the excess value because under defined benefit plans they bear the risk of a drop in the value of plan assets. Thus, it is only fair that they benefit from a rise in those assets' value.\textsuperscript{82} Consequently, employees are not rewarded

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\begin{itemize}
  \item \textsuperscript{75} Id.
  \item \textsuperscript{76} Arguably these transactions accomplish indirectly, in two steps, what could not have been accomplished directly in one step.
  \item \textsuperscript{77} See Pension Funding Problems: Hearings Before the House Select Comm. on Aging, 97th Cong., 2d Sess. 115 (1982) (prepared statement of Ira Cohen, Director, Actuarial Division, Internal Revenue Service) [hereinafter cited as Cohen statement].
  \item \textsuperscript{78} See Grubbs, supra note 6, at 203-04.
  \item \textsuperscript{79} See Cohen statement, supra note 77, at 115-16.
  \item \textsuperscript{80} See supra note 38.
  \item \textsuperscript{82} Hearings on S. 2435, supra note 29, at 52, 59 (statement of Ed Davey, Exec. Dir. of Assoc. of Private Pension and Welfare Plans, Inc.).
\end{itemize}
for employers’ risk-taking. This position is supportable under ERISA because the Act carves out a specific exception to the exclusive benefit rule in the event of plan termination.

On the other hand, employees and their supporters argue that the excess assets in an overfunded plan represent cost-of-living protection for retiree benefits and that had ERISA required employers to grant cost-of-living increases, these excess assets would not exist. Moreover, these excess assets may benefit employer and employee alike in the event of a sudden drop in the value of plan assets by protecting the plan against potential funding deficiencies. Thus, there is some basis for arguing that these excess assets should be distributed to plan participants upon termination of an overfunded plan.

ERISA provides that upon termination of a plan any excess assets attributable to employee contributions should be equitably distributed to the employees. In contributory plans, which require employee contributions as a precondition to participation, employee contributions typically become fully vested and nonforfeitable, so the employer cannot receive any excess assets. There also are contributory defined benefit plans that provide for voluntary or mandatory employee contributions. Thus, for such plans, it is conceivable that a portion of the excess assets would be attributable to employee contributions and therefore distributable to employees.

### III. LEGISLATIVE POLICY OPTIONS

The Plan Termination and Reversion Control Act of 1985

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83. Id.
84. See supra note 31.
87. ERISA defines “vested liabilities” as “the present value of the immediate or deferred benefits available at normal retirement age for participants and their beneficiaries which are nonforfeitable.” ERISA § 3(25), 29 U.S.C. § 1002(25) (1982).
89. Id. §§ 14.02-.04, at 14-2 to 14-9. In such cases, the proportion of excess plan assets attributable to employee contributions is easily determinable. In reality, however, even with plans that are funded solely by employer contributions, arguably employees carry the burden of these contributions through reduced wage rates. Thus, it is unclear how one can draw a clear line between employee and employer contributions.
90. H.R. 2701, supra note 23.
and conditional employer withdrawals from ongoing plans have been proposed to curb the growth of pension plan terminations with asset reversions to employers. In spite of concern for employees' retirement income security, it is clearly inadvisable to amend current law to prohibit absolutely plan terminations with asset reversions to employers. Such a drastic legislative measure would inevitably result in a reluctance among employers to establish defined benefit plans because they perceive the ability to recapture excess plan assets as one of the advantages of such plans. Instead, current law should be changed to the extent necessary to reduce employer incentives to terminate overfunded pension plans. The Plan Termination and Reversion Control Act of 1985 and conditional employer withdrawals from ongoing plans seek to accommodate the best interests of both employers and employees in regard to plan terminations.

A. The Plan Termination and Reversion Control Act of 1985

In response to public concern about the escalating number of plan terminations within the last few years, Representative Roybal recently introduced H.R. 2701. The bill seeks to create a federal policy that protects the retirement income security of workers from the danger plan terminations and asset reversions pose.

The bill's main feature is a business necessity test that allows plan terminations prompted by impending bankruptcy, financial insolvency, or other business hardship. Moreover, it is clear under this bill that termination of a pension plan to recapture assets for a corporate purpose, such as thwarting takeover attempts, would not constitute a business necessity. A plan termination meeting the business necessity test, however, will allow the plan sponsor to establish a comparable successor plan that preserves the pretermination present value of participants' benefits. This provision would help prevent reductions in retire-
ment benefits due to insufficient lump-sum cash payments made following a plan termination, as in *Harper & Row*.

A shortcoming of the bill is that it does not address the issue of the appropriate actuarial and interest rate assumptions that should be used in determining the present value of pretermination benefits. In cases of mandatory lump-sum cash payments, it is particularly important that these assumptions be fair and realistic. Otherwise, recipients of these payments are left without sufficient means for providing for their future retirement.

Plan terminations that do not meet the business necessity test would result in the ratable distribution of any excess assets to both active and retired plan participants. Failure to make this distribution would constitute a fiduciary violation under ERISA. Any amount of excess assets not distributed to plan participants in a nonbusiness necessity termination would be subject to a ten percent excise tax. This tax would be calculated as ten percent of the fair market value of the assets recaptured by the employer. The question arises, however, whether this ten percent tax is enough of a deterrent to prevent employers from taking the risk of recapturing assets that should have been distributed to plan participants. An employer who stands to recapture several million dollars in plan assets may not balk at a ten percent penalty for doing so. Thus, perhaps this tax should be higher to prevent employers from easily incorporating it into the costs of the plan termination.

Another major problem under current practice that this bill severely limits is the ability of employers to engage in spinoff or termination reestablishment schemes. If a plan terminates without meeting the business necessity test, the bill prohibits the employer from instituting a comparable plan for a five-year

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99. Roybal, supra note 2, at E2615.
100. H.R. 2701, supra note 23, § 7.
101. Id.
102. The ten percent excise tax applies to terminations that meet the business necessity test as well as those that do not. Id. Although one could argue that the tax deters all terminations, not just those for nonbusiness necessities, the tax appears to be designed to prevent nonbusiness necessity terminations because they comprise the majority of terminations. See Roybal, supra note 2, at E2617. Another reason why the tax's purpose appears to be to deter nonbusiness necessity terminations is that plan sponsors with a great need for funds may have no choice but to terminate the plan, while sponsors who want to terminate for a nonbusiness necessity reason do not feel compelled to terminate the plan and therefore may be influenced by the tax.
103. For a discussion of these schemes, see supra note 17.
period.¹⁰⁴ Even if a business necessity exists for the termination, comparable successor plans established within five years after termination become subject to expedited funding schedules to guarantee an adequate cushion of assets for funding future benefits.¹⁰⁵

Although restrictions on the ability of employers to establish comparable successor plans after a nonbusiness necessity termination are responsive to a major problem, this provision of the bill may encourage employers to establish defined contribution plans following plan termination, because they are not covered by the provisions of ERISA or the qualified trust section of the IRC.¹⁰⁶ Because of the uncertainty that such plans present for employees,¹⁰⁷ it is clearly in the best interests of employees to reduce the incentives of employers to terminate their current defined benefit plans.

Although this bill offers some viable solutions to many of the problems of plan terminations and asset reversions, it fails to reduce adequately the incentives for termination and subsequent establishment of defined contribution plans. Instead, the bill makes the termination of defined benefit plans riskier for employers because of the restricted access to excess plan assets upon termination. Thus, the bill encourages the establishment of defined contribution plans that impose substantial risk and uncertainty on the covered employees.

B. Conditional Employer Withdrawals from Ongoing Plans

In an effort to reduce employer incentives to terminate merely to recapture excess assets, it has been proposed that ERISA and the IRC be amended to allow conditional employer withdrawals of assets from ongoing plans.¹⁰⁸ This proposal is the most attractive way to allow employers to capture excess assets because, when a business necessity exists, it would allow an employer to use the excess assets without terminating the plan. Although the excess assets remain for the benefit of employees, an employer

¹⁰⁴ See Roybal, supra note 2, at E2618; H.R. 2701, supra note 23, § 6.
¹⁰⁶ 26 U.S.C. § 412(h), (i) (1982) excepts from minimum funding standards certain profit-sharing plans, employee stock purchase plans, and plans funded through insurance contracts, all of which are forms of defined contribution plans that are becoming increasingly popular among large employers.
¹⁰⁷ See supra notes 65-66 and accompanying text.
¹⁰⁸ See Grubbs, supra note 6, at 202-03.
may use the funds under specific conditions. As a result, the issue of fairness to the employees is indirectly resolved because the assets are returned to the plan for plan participants.

The major weakness of this proposal is the potential danger it poses to the security of accrued benefits. As a response to this potential problem, the proposal contains three qualifications for withdrawals from an overfunded, ongoing plan. First, the amount withdrawn from the plan could not exceed the value of all accrued benefits. Thus, the accrued benefits of plan participants would remain fully funded. Second, withdrawals from the plan would be treated as actuarial losses and thus amortized over the usual fifteen-year period. Third, an employer would be required to protect accrued benefits against a precipitous drop in the value of plan assets that could occur soon after the withdrawal. This protection would take the form of a cushion of assets of a value greater than the value of the accrued benefits. This cushion would afford added protection to accrued benefits and future benefits as well by providing additional funds in the event of a sudden drop in the value of plan assets.

Although clearly prohibited under current law, this proposal provides some flexibility for accommodating the needs of employers while protecting employees from the possibility of plan termination. Because of the inherent potential for abuse in allowing such a practice, it would be critically important that the business necessity test be strictly applied in these circumstances. It is also important that employers are limited in the number and amount of withdrawals allowed over a specified period of time. Otherwise, withdrawals of plan assets by employers could become as threatening to the retirement income security of employees as are asset reversions under the current practice.

CONCLUSION

In view of the enormous growth in overfunded plan terminations, significant legislative and administrative reforms are nec-

109. Id. at 202.
110. Id.
111. Id. at 203.
112. Id. at 202-03.
113. Id. at 203.
114. Under current law, assets may be distributed to employers only in the event of plan terminations. See supra note 31.
ecessary to resolve the current inequities. Unless these reforms are instituted, the retirement income security of millions of American workers will be jeopardized.

The Plan Termination and Reversion Control Act of 1985 is a step in the right direction for reforming current pension law, but it lacks sufficient incentives to keep employers from terminating defined benefit plans that are in the best interests of employees. Indeed, the bill, by making it more difficult to reach plan assets, could even make employers reluctant to establish such a plan in the first instance.

The proposal for allowing conditional withdrawal of assets from an ongoing plan holds substantial promise for significantly reducing employer incentives to engage in plan termination. By allowing employers to withdraw assets from an ongoing plan, the proposal seeks to accommodate the legitimate business needs of employers in financial distress. A strict set of rules and guidelines, however, is necessary to ensure that such a practice would not become abusive and detrimental to the retirement income security of plan participants.

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