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Legal Issues in Terminations of Single-Employer Pension Plans: *Beck v. PACE International Union*

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Summary

On January 19, 2007, the U.S. Supreme Court granted certiorari in *Beck v. PACE International Union*. The case concerns the decision by an employer in bankruptcy proceedings to terminate its pension plans. The employer, which was both plan sponsor and administrator, had the option of terminating the plans by buying annuities for plan participants and beneficiaries or by merging the plans with a multiemployer plan. It chose the annuity option. At issue in *Beck* is whether the employer breached the fiduciary duty owed under the Employee Retirement Income Security Act (ERISA) to plan participants and beneficiaries by failing to adequately consider the merger proposal. This report discusses the *Beck* case and will be updated as events warrant.

Under the Employee Retirement Income Security Act of 1974 (ERISA), a single-employer defined benefit pension plan[1] may be terminated at the employer's discretion. If a plan's assets are sufficient to meet its benefit liabilities, this process is called a "standard termination."[2] The plan administrator initiates a standard termination by giving written notice to affected parties, reporting information about the plan's assets and benefit liabilities to the Pension Benefit Guaranty Corporation (PBGC), and informing the participants and beneficiaries of the benefits due them. The PBGC then looks at the information to determine whether the criteria for a standard termination have been met.

If the PBGC approves the termination, the next step is for the plan administrator to distribute the plan's assets to its participants and beneficiaries in order to provide the

[1] Defined benefit plans are those where participants are promised a specified future benefit, which is traditionally an annuity beginning at retirement.

[2] ERISA § 4041(b); 29 U.S.C. § 1341(b). For more information on pension plan terminations, see CRS Report RS22624, *The Pension Benefit Guaranty Corporation and Single-Employer Plan Terminations*, by Jennifer Staman and Erika Lunder.

benefits due them. ERISA § 4041(b)(3) requires that these distributions be done through the purchase of annuities from a commercial insurer or by other means that fully provide the benefits and are permissible under the plan's terms and PBGC regulations.[3] If any assets remain after the distribution, they may be given back to the employer sponsoring the plan so long as all liabilities to participants and beneficiaries have been satisfied and the reversion is permissible by law and under the plan terms.[4]

Beck v. PACE International Union

Facts of the case. In 2000, Crown Vantage, Inc. and Crown Paper Co. (collectively referred to as "Crown") filed for Chapter 11 bankruptcy. At that time, Crown was the sponsor and plan administrator for 17 pension plans covering its hourly workers, 12 of which were overfunded. In the bankruptcy proceedings, the PBGC filed proofs of claims for the liabilities it would assume under ERISA's plan insurance termination program[5] if it was forced to take over the company's pension plans. Because the liabilities were worth millions of dollars, the bankruptcy court saw the PBGC's claims as problematic for the Chapter 11 plan confirmation.[6]

In 2001, Crown's board of directors decided to look at the possibility of terminating the plans under a standard termination. As part of this effort, they sought bids for annuities that would be used to make the final distribution of benefits to plan participants and beneficiaries. A few months later, PACE International Union, which was the union for Crown's hourly workers, suggested that Crown's plans merge with the PACE Industrial Union Management Pension Fund (PIUMPF), a multiemployer pension plan for PACE union members. PACE thought the merger would be beneficial for Crown's workers because PIUMPF would provide additional benefits and an established dispute resolution program.

In the following months, attorneys from Crown and PACE discussed the merger and exchanged a draft merger agreement. Crown's board was informed of the merger proposal and agreed to compare the options of purchasing annuities and merging once it received the final annuity bids. Shortly thereafter, Crown's board met to look at the final annuity bids, which were set to expire the next day, and learned that the PBGC had agreed to release its claims if Crown purchased the annuities. The board then decided to buy the annuities in order to terminate the 12 overfunded plans. Because the plans were

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[3] 29 U.S.C. § 1341(b)(3).

[4] ERISA § 4044(d); 29 U.S.C. § 1344(d). A reversion is subject to tax at a 20% rate, which is increased to 50% if the employer does not take certain actions such as establishing a qualified replacement plan. Internal Revenue Code § 4980.

[5] For more information on the insurance termination program, see CRS Report 95-118, *Pension Benefit Guaranty Corporation: A Fact Sheet*, by Paul J. Graney.

[6] Chapter 11 bankruptcy is considered to be a "reorganization," in which a debtor may restructure its debt according to a court-approved plan. Generally, the debtor is in charge of the reorganization process, but creditors and certain other parties can have a voice in the formation of a Chapter 11 plan of reorganization. The PBGC, when taking over a pension plan from an employer in a Chapter 11 bankruptcy proceeding, is considered to be creditor.

overfunded, there was an estimated $5 million reversion to Crown. The other five plans became the responsibility of a prior plan sponsor's successor.

PACE and two plan participants then sought a preliminary injunction to prevent Crown from terminating the plans. They alleged that Crown had violated its fiduciary duty under ERISA by failing to adequately consider the merger proposal.

Breach of fiduciary duty. ERISA requires that a plan fiduciary act "solely in the interest of the participants and beneficiaries" and "for the exclusive purpose" of providing benefits and defraying reasonable administrative expenses.[7] A fiduciary must act "with the care, skill, prudence, and diligence" of a prudent person "acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims."[8]

Under ERISA, a "fiduciary" includes anyone who "exercises any discretionary authority or discretionary control respecting management of [a] plan or exercises any authority or control respecting management or disposition of its assets" or "has any discretionary authority or discretionary responsibility in the administration of such plan."[9] These activities do not include plan design or business decisions, which include decisions to adopt, modify, or terminate a pension plan.[10] However, the implementation of the decision to terminate a plan is an administration decision that implicates a fiduciary responsibility to the plan participants and beneficiaries.[11]

There are two basic issues in *Beck* regarding whether Crown breached ERISA's fiduciary duty requirements. The first issue is whether ERISA permits a merger as a means of plan termination. This is a key question because Crown could not have breached any fiduciary duty it may have owed under ERISA if it could not have legally chosen to terminate the plan by merger. In addition, if ERISA does not permit a plan to terminate by merger, Crown may not have had access to the reversion. No section in ERISA explicitly provides that a standard termination may occur by merging the terminating plan with a multiemployer plan. Furthermore, the ERISA section that addresses plan mergers between single-employer and multiemployer plans, ERISA § 4232, does not speak to single-employer plan terminations.[12] Thus, the question raised

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[7] 29 U.S.C. § 1104(a)(1).

[8] *Id.*

[9] 29 U.S.C. § 1002(21).

[10] *See* Lockheed Corp. v. Spink, 517 U.S. 882; Hughes Aircraft Co. v. Jacobson, 525 U.S. 432 (1999).

[11] *See* Larson v. Northrop Corp., 21 F.3d 1164 (D.C. Cir. 1994); Waller v. Blue Cross, 32 F.3d 1337 (9th Cir. 1994).

[12] 29 U.S.C. § 1412(f)(3). This section contains a list of requirements that must be met by a merger or transfer of assets or liabilities between a multiemployer plan and a single-employer plan. The section has two provisions dealing with plan terminations: (1) it requires that a multiemployer plan remain liable to the PBGC if the plan transfers its liabilities to a single-employer plan that terminates within 60 months of the transfer and (2) requires any transfer "in connection with" a multiemployer plan termination comply with PBGC requirements

(continued...)

by *Beck* is whether ERISA § 4041(b)(3), which provides that plan assets must be distributed in a standard termination in the form of annuities, or by means that "in accordance with the provisions of the plan and any applicable regulations, otherwise fully provide all benefit liabilities under the plan,"[13] permits the distribution to occur through a plan merger.

The second issue is whether the decision to choose the merger option is a discretionary administrative decision subject to ERISA's fiduciary obligations or is a plan design or business decision not subject to such obligations. Prior to *Beck*, it does not appear that any court had addressed whether the decision to terminate a plan by merger implicates ERISA's fiduciary duty standards. However, several federal courts of appeals have held outside the scope of plan terminations that no fiduciary duty arises when a plan sponsor chooses to merge a pension plan with another plan.[14]

Bankruptcy Court. The bankruptcy court found that Crown had breached its fiduciary obligations to plan participants and beneficiaries. Accordingly, it issued a preliminary injunction, ordering the reversion be held in an interest-bearing account until the parties reported on the feasibility of distributing the reversion to plan participants.[15] The parties subsequently submitted a joint proposal on the reversion distribution,[16] which the court approved.[17]

District Court. In 2003, the U.S. District Court for the Northern District of California affirmed the bankruptcy court's preliminary injunction after finding that Crown had breached its fiduciary duty by not properly considering the merger proposal as an alternative means of plan termination.[18]

Before the district court, Crown argued that the decision of whether to merge the plans into PIUMPF was a business decision and therefore outside the scope of ERISA's

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[12] (...continued)
established to reduce risk to the corporation.

[13] ERISA § 4041(b)(3); 29 U.S.C. § 1341(b)(3).

[14] *See* Malia v. Gen. Elec. Co., 23 F.3d 828, 834 (3rd Cir. 1994) (where the court stated that "[e]fforts by an employer to merge two pension plans do not invoke the fiduciary duty provisions of ERISA. Such duties do not attach to business decisions related to modification of the design of a pension plan"); Sutter v. BASF Corp., 964 F.2d 556, 562 (6th Cir. 1992) (where the court stated that the plan sponsor's "decision to merge the two plans ... clearly constituted the establishment or amendment of a pension plan and is therefore a business decision that should not be overturned by the court in the absence of violation of state or federal law").

[15] PACE Int'l Union v. Crown Vantage, *Transcript of Proceedings Hearing Re Tro, Preliminary Injunction Telephonic Conference*, Case No. 00-41584 N; 00-41583 N (Bankr. N.D. Cal., Dec. 11, 2001).

[16] PACE Int'l Union v. Crown Vantage, Inc., *[Joint Proposed] Order on Motion for Preliminary Injunction*, Case No. 00-41584 N (Bankr. N.D. Cal., Feb. 2, 2002).

[17] Beck v. Pace Int'l Union, 146 Fed. Appx. 917, 918 (9th Cir. 2005).

[18] Beck v. PACE Int'l Union, 2003 U.S. Dist. LEXIS 2283, No. C 02-1407 MHP (N.D. Cal. Jan.. 10, 2003). Among other things, the court also held that PACE did not have standing to bring a claim under ERISA. *See id.* at *10-15.

fiduciary obligations. Alternatively, Crown also argued that even if a fiduciary duty did arise, it did not breach that duty because the merger would not have been permissible under ERISA. The district court rejected both of Crown's arguments. It began by describing Crown's claim that ERISA did not allow a merger as "not persuasive."[19] The court found that merger was an option under the plain meaning of the statutory language in ERISA § 4041(b)(3), which provided for the plan administrator to make the final distribution of assets by purchasing an annuity or "otherwise fully provid[ing] all benefit liabilities under the plan" so long as it was consistent with the regulations and plan terms.[20] Looking at this language, the court stated "a plan administrator can implement a merger to terminate a plan, if the merger can cover all benefit liabilities under the plan and complies with the terms of the plan and 'any applicable regulations.'"[21] The court further supported its conclusion by noting that both ERISA § 4041, dealing with standard terminations, and ERISA § 4232, dealing with asset transfers between single and multiemployer plans, were in the subchapter of ERISA entitled "Plan Termination Insurance."

After finding a standard termination could be accomplished through a plan merger, the court then addressed the fiduciary duty issue. The court, noting that Crown had not challenged the bankruptcy court's findings that the company's directors had not made "the intensive and scrupulous investigation of the plan's investment options and the circumstances required," held that the directors had breached their fiduciary duty by "fail[ing] to consider the merger option seriously while acting as plan administrators."[22] Thus, the court affirmed the bankruptcy court's preliminary injunction.

Ninth Circuit Court of Appeals. The Ninth Circuit affirmed the district court's finding that merger into a multiemployer plan can be a means of terminating a pension plan under ERISA. It also affirmed the district court's decision that the Crown directors had breached their fiduciary duty.[23]

In evaluating whether Crown breached its fiduciary duties, the court first examined whether ERISA permits a merger as a means of terminating a single-employer plan.[24] Crown argued, among other things, that ERISA's provision covering standard terminations was exclusive, and did not include merger as a means of plan termination. The court looked to the language of ERISA § 4041, and reasoned that methods of terminating a plan not specifically mentioned in the statute may be permissible, so long as the method is sufficient to cover plan liabilities. The court determined that the text of

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[19] *Id*. at *23.

[20] 29 U.S.C. § 1341(b)(3).

[21] *Id*. at *23-24.

[22] *Id*. at *25.

[23] Beck v. PACE Int'l Union, 427 F.3d 668 (9th Cir. 2005). The Ninth Circuit Court of Appeals remanded the case on the issue of whether PACE should have standing to the Bankruptcy Court. *See id.* at *679.

[24] *See id.* at *674.

ERISA neither explicitly or implicitly prohibits merger as a means of termination of a pension plan, and it affirmed the district court.[25]

Next, the court turned to the merits of the breach of fiduciary duty claim.[26] The court noted that Crown did not have a duty to use the fund's assets to the "beneficiaries' optimum benefit" and that a reversion, under certain circumstances, is acceptable. However, the court pointed to the findings of the bankruptcy court and held that there was evidence indicating that Crown was focused on an "improper set of interests."[27] The court agreed with the lower court's findings that Crown breached its fiduciary duty by failing to prioritize the participant's interests and also by failing to make an investigation of the plan's investment options.[28]

Supreme Court. Crown appealed the case to the U.S. Supreme Court. After asking the Solicitor General to file a brief expressing the views of the United States on the case,[29] the Court granted Crown's petition for certiorari on January 19, 2007.[30] Oral arguments are scheduled for April 24, 2007. The question presented in the petition is:

> Whether a pension plan sponsor's decision to terminate a plan by purchasing an annuity, rather than to merge the pension with another, is a plan sponsor decision not subject to ERISA's fiduciary obligations.

The Supreme Court's upcoming decision may shed light on the scope of ERISA's fiduciary duty provisions. More specifically, the Court may address what fiduciary duties apply when a plan administrator decides to terminate a plan. The Supreme Court may also determine whether merger is a permissible means of a single-employer plan termination.

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[25] *Id.* at *676.

[26] *Id.*

[27] *Id*. at 678.

[28] The Secretary of Labor filed an amicus brief with the Ninth Circuit in support of a petition for rehearing. Brief for Amicus, Nos. 03-15303, 03-155331(9th Cir. 2005). The Secretary argued that the decision to terminate or merge the Crown plan was not subject to ERISA's fiduciary obligations. It appears the PBGC also filed an amicus brief in which it argued that merger was not a permissible means to accomplish a standard termination under ERISA. *See* Petition for Writ of Certiorari at 14, Beck v. PACE Int'l Union, 427 F.3d 668 (9th Cir. 2005), *cert. granted*, 127 S. Ct. 1144, (Jan. 19, 2007).

[29] Brief for Amicus, No. 05-1448 (December 2006), available at [http://www.usdoj.gov/osg/briefs/2006/2pet/6invit/2005-1448.pet.ami.pdf].

[30] Beck v. PACE Int'l Union, No. 05-1448, 127 S. Ct. 1144 (Jan. 19, 2007).