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

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Summary

The *Beck v. PACE International Union* case concerned 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* was 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. The Supreme Court found that the employer did not breach its fiduciary duty in failing to consider PACE's merger proposal, because merger is not a permissible form of plan termination under ERISA. This report discusses the *Beck* case and will be updated as events warrant.

Contents

Contacts

Background

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 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]

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.[5] 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."[6]

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."[7] These activities do not include plan design or business decisions, which include decisions to adopt, modify, or terminate a

[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.

[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] 29 U.S.C. § 1104(a)(1).

[6] *Id*.

[7] 29 U.S.C. § 1002(21).

pension plan.[8] However, the implementation of the decision to terminate a plan is a decision that implicates a fiduciary responsibility to the plan participants and beneficiaries.[9]

There are two basic issues in *Beck* regarding whether the defendant employer 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 the employer 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, the employer 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.[10] Thus, the question raised 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,"[11] 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.[12]

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

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

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

[10] 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 established to reduce risk to the corporation.

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

[12] *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").

plan insurance termination program[13] 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.[14]

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 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.

Lower Court Opinions

The bankruptcy court held in favor of PACE, finding that (1) the decision of whether to purchase annuities or merge the plans was a fiduciary decision, and that (2) Crown had breached its fiduciary obligations to plan participants and beneficiaries in failing to adequately consider PACE's merger proposal. The U.S. District Court for the Northern District of California affirmed the bankruptcy court's decision in relevant part.[15] The Ninth Circuit, in affirming the decision of the district court, found that merger into a multiemployer plan can be a means of terminating a pension plan under ERISA. It also held that the Crown directors had breached their fiduciary duty.[16] In evaluating the merits of the breach of fiduciary duty claim, 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

[13] For more information on the insurance termination program, see CRS Report 95-118, *Pension Benefit Guaranty Corporation: A Fact Sheet*, by (name redacted).

[14] 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.

[15] 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.

[16] 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.

of the bankruptcy court and held that there was evidence indicating that Crown was focused on an "improper set of interests."[17] 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.[18]

Supreme Court

In reversing the decision of the lower court, the Supreme Court did not focus on whether Crown's decision to purchase an annuity instead of merging the pension plans was a fiduciary decision.[19] Instead, the Supreme Court found that Crown did not breach its fiduciary duty in failing to consider PACE's merger proposal, because merger is not a permissible form of plan termination under ERISA.

In its decision, the Supreme Court looked at the language of Section 4041(b)(3) of ERISA, under which 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." PACE had argued that mergers could fall within this "otherwise" language, as the merger of assets into the multiemployer plan could fulfill plan benefit obligations. The Court however, sided with the PBGC's interpretation of the section, that merger should be viewed as "an *alternative* to (rather than an example of) plan termination."[20] The Court also pointed out that Congress had not expressly provided for merger as a means of plan termination.

In support of its position, the Court provided three ways in which ERISA treats merger and termination differently. First, the Court explained that if a plan terminates through the purchase of annuities, ERISA ceases to apply to both the employer and the remaining plan assets. A merger on the other hand "represents a *continuation*, rather than a *cessation* of the ERISA regime."[21] The Court pointed out that had the plans been merged into the larger multiemployer plan, that Crown could still be subject to ERISA's requirements if it employed plan participants.

Second, in a standard termination, ERISA allows an employer to recover surplus amounts not necessary to pay plan liabilities. Had Crown merged the plan, it would not have been able to take back those assets, due to ERISA's anti-inurement provision, which prohibits employers from obtaining a reversion "in the absence of termination." The Court found that it was reasonable for the PBGC to refuse to recognize a termination mechanism that did not allow for the receipt of these funds, as authorized by law.

[17] *Id*. at 678.

[18] 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).

[19] *Beck v. PACE International Union*, 127 S. Ct. 2310 (2007).

[20] *Id.* at 2317. The Court noted that in order to find for PACE, it would have to decide that merger was an acceptable method of plan termination. The Supreme Court expressed its reluctance not to defer to the PBGC, and that "to answer these questions without the views of the agencies responsible for enforcing ERISA, would be to embark upon a voyage without a compass." Id. (*quoting Mead Corp. v. Tilley*, 490 U.S. 726, 1(1989) (internal quotation marks omitted).

[21] *Beck*, 127 S. Ct. at 2319.

Third, the Court pointed to the structure of ERISA as evidence that merger was not to be included as a permissible means of termination. The Court explained that provisions dealing with merger are contained in a different set of statutory sections that maintain different rules and procedures. While PACE had argued that a company could, theoretically, follow both the rules for merger and termination, the Court found this reasoning flawed. Accordingly, the Court held that merger is not a permissible method of terminating a single-employer defined benefit plan.

Concluding Observations

The *Beck* case has been considered a narrow decision, in part because, as commentators have pointed out, the facts of the case, a determination of whether to terminate a plan through merger, is a "unique situation."[22] In addition, while the lower courts addressed whether the decision to purchase annuities or merge the plans was a fiduciary decision, the court acknowledged this issue, but focused on an "antecedent question," namely, whether merger is a permissible form of plan termination under ERISA. Thus, questions may still remain as to the scope of fiduciary duty following a decision to terminate a pension plan. It has also been noted that the *Beck* case did not foreclose the possibility that pension plans can be terminated in ways other than an annuity or a lump-sum payment.[23]

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[22] *See* Jo-el J. Meyer, *Attorneys Say Beck Ruling on Plan Mergers is Narrow but Has Fiduciary Implications*, Pension and Benefits Daily Vol. 7, No. 116 (June 18, 2007).

[23] *Id.*