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# Pension Plan Minefields For Distressed Auto Equipment Cos.


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*Law360, New York (September 29, 2014, 11:17 AM ET)* -- Few people understand the complexities of defined benefit pension plans, particularly those of distressed companies. For attorneys who work with clients or lenders in the automotive equipment business, these issues can be difficult to navigate without guidance from experts to help deal with the complicated and sometimes arcane issues involved.

Defined benefit pension plans are highly regulated and subject to a variety of statutes and rules, including oversight by Pension Benefit Guaranty Corporation (PBGC), whose mission is to protect benefits in private sector defined benefit plans. Even in the best of circumstances, it can be difficult to determine the status or health of a company's plan. But failure to do so can materially raise the risks involved in a transaction or credit agreement, or even the ongoing viability of a company.

This is particularly true in the automotive equipment industry. The industry represents a significant portion of the troubled defined benefit plans overseen by the PBGC. The federal agency currently oversees troubled pension plans that affect more than 1 million of the 10.4 million people in multi-employer plans. In 2011, payments by the PBGC to motor vehicle industry pension beneficiaries represented 14.3 percent of the agency's total paid, or approximately $776 million.[1] As a result of this magnitude, the federal agency is very cognizant of the issues affecting such plans and monitors them closely. Corporate counsel of automotive equipment companies, attorneys representing parties involved in transactions, and lawyers for lenders all need to anticipate PBGC's attentive oversight.

**Not an Easy Task**

Corporate counsel for automotive equipment companies are usually aware of the complexities of their own company's defined benefits plans, but they may not know the implications of an acquisition or other transaction involving another company. Detailed review of the status of an entity's pension funds is a must for them, but it is also especially important for the parties representing lenders to and buyers and sellers of companies.

A "deep-dive" review is the only way buyers and lenders can effectively analyze and understand the risks involved in a transaction or credit agreement. Failure to do so could result in the client company assuming additional obligations, causing delay in completing the transaction, or impairing the priority status of the secured loan.

Lenders' and buyers' due diligence efforts must include a thorough examination of the entity's retirement promises to its workers and retirees and the status of the related pension plans. In addition, in the case of closely held companies, appropriate inquiries and diligence must extend beyond the target into the existence and health of pension plans of other entities which share certain common ownership characteristics with the target. Companies that are considered members of a "controlled group" may be deemed responsible for the plan liabilities of the other members of the group.

**Consequences Can be Significant**

Even though companies reflect the funded status of their pension plans on their balance sheets, different standards exist for financial reporting purposes and annual reporting to PBGC and the U.S. Department of Labor.

In the event a plan termination is threatened, the valuation of the plan's unfunded benefit obligation is determined by a third set of rules which are more conservative than those actuaries employ for plans on a going concern basis. Under these more conservative rules, a company's obligations to its pension plan are likely significantly greater than the obligation reported on the company's financial statements.

To assess the extent of the issues that may exist, companies and lenders should undertake:

- A close vetting of the numbers during due diligence
- A review of the entity's historic actions toward its plans
- An accurate appraisal of the entity's dealings with PBGC.

Clearly it is best to have experienced experts involved in this due diligence process.

In support of PBGC's mandate of protecting pension benefits, ERISA and other related statutes provide PBGC with special powers. When a contributing sponsor fails to make required contributions in excess of $1 million, by statute, a lien is imposed on all property of the sponsor and that of all members of the controlled group. When the sponsor reaches the $1 million threshold, it is required to file certain information with PBGC. The filing on Form 200 includes detailed financial information PBGC deems necessary for decision-making in enforcing the lien triggered by the failure to make the payments. The imposition of PBGC's lien can affect other secured lenders such as those who advance on a revolving credit basis. As the revolving credit is paid down and re-lent, PBGC's statutory lien primes the secured lender at each pay-down of the revolver.

This situation affects not only the status of the lender to the sponsoring entity, but also lenders to other members of the controlled group since the statutory lien extends to the assets of all members of the controlled group.

As part of any due diligence effort, lenders should be inquiring about the status of required payments not only at the potential borrower but also with other affiliated entities which would be part of a controlled group. This is particularly important in situations where a lender is considering a loan to an entity that is a subsidiary or affiliate issuing stand-alone financial statements. While the entity's status as a controlled group member should be disclosed in the Commitments and Contingencies footnote if material, the importance of such a disclosure could be overlooked, particularly in smaller, privately held companies.

There is a clear red flag to the lender if any member of a controlled group has been required to file Form 200 with PBGC. However, inquiring about missed payments below the $1 million threshold is an early alert to the potential issues that may soon be a threat to the lender's position. This can be done during field examinations, and lenders' attorneys should consider raising these issues on an annual basis. If necessary, the lenders may find it helpful to have the borrower's CEO, CFO or general counsel certify the status of the required payments.

**Asset Purchases May be Hazardous, Too**

Successor liability has always been an issue in merger and acquisition transactions involving entities with defined benefit pension liabilities.

A successor entity may be responsible for ERISA debts of the predecessor if:

- The successor employer had prior notice of the claim against the predecessor,
- The predecessor was able, prior to the purchase, to provide the relief requested,
- Or there was sufficient continuity in the business operations of the predecessor and successor.

It is worth noting that PBGC has pursued claims against non-U.S. controlled group members and experienced some recent success as well.

**Avoiding the Minefields is Possible**

Despite the potential for significant complications, it is possible to navigate safely through the complexities of acquiring or lending to distressed companies with pension plans.

Foremost among the steps that must be taken is rigorous due diligence, guided by experts. Correctly carried out, this process will identify existing and potential issues, and allow potential buyers and lenders to make informed decisions about whether to proceed with the transaction or credit, and under what terms.

Among the key questions to answer are:

- How overfunded/underfunded is the pension plan?

- Has the company/borrower failed to make required payments? If so, with accrued interest, how close is the entity to the $1 million threshold?

- Is the borrower/target part of a controlled group? If so, it is important to conduct the necessary due diligence to understand whether there are joint and several liabilities for which the entity may be responsible.

In circumstances that warrant it, the acquirer or lender should enter into negotiations with PBGC. This also requires expertise and an understanding of PBGC's objectives. PBGC is a focused and hardworking group, as well as very tough negotiators. However, it is possible to engage in meaningful discussions with the staff to reach reasonable economic resolution of issues when it is possible to do so.

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[1] Source: PBGC Statistics by Industry (2011)