CHAPTER 10

Selected Developments Affecting Qualified Plans: Of Same Desks, Plan Spinoffs and Mergers, and Plan Procedures

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SYNOPSIS

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§ 10.01 INTRODUCTION

In spite of the flurry of legislative and regulatory activity over the past few years, some of the most important developments in the qualified plan area continue to occur in the courts. For example, in just the last year or so, there have been a number of "same desk" cases that will have important effects on the treatment of qualified plan benefits in corporate divestitures. The courts also have charged into the related thicket of plan mergers and spinoffs. And there even have been a few cases on plan procedures that threaten to turn the sleepy area of plan boilerplate into a nightmare.

Together, these cases reaffirm the importance of the courts in areas that previously were dominated by the Internal Revenue Service and other regulatory agencies. In fact, the Service and the Department of Labor must be pleased by some of these developments, as they watch plaintiffs push the law in ways that they probably could not. Undoubtedly, this relative advantage is due "in part" to the fact that individual plaintiffs evoke more judicial sympathy than a bureaucracy ever could.

§ 10.02 SAME DESK RULE

[1] Background

May a pension plan commence distributions when there is a sale or divestiture? Must the seller's plan continue to recognize service with the buyer for purposes of entitlement to early retirement benefits? The questions don't get much more basic than these; yet this is an area where the law continues to develop slowly and erratically.

One aspect of this development is particularly interesting. For some reason, the Service and the courts seem to be addressing separate pieces of this puzzle. The Service has weighed in more on the issue of distributions, while the courts have had quite a bit to say about service counting. This is somewhat odd, since the two questions are integrally related. It is also undoubtedly one of the reasons for the persistent doctrinal confusion in this area.

[2] Distributions: PLR 8614060 and GCM 39824

Until 1986, plan sponsors pretty much had their own way in deciding whether to allow distributions or to credit service. In 1986, however, the Service dropped a bombshell — the Service privately ruled that distributions may not be made from a pension plan upon the sale or other disposition of a business.[1] The ruling cited the authorities under the Code section 402 "separation from service" doctrine involving lump sum distributions for the proposition that a sale or disposition does not cause a "termination of service" that would trigger a distribution from a pension plan under Code section 401.[2]

The ruling stirred an immediate and strong reaction from plan sponsors. The 1986 ruling, they claimed, overturned a long-standing IRS practice of allowing pension plan payouts in such cases. In 1990, the IRS reversed its position, or at least the IRS Chief Counsel's office did so in the form of General Counsel's Memorandum (GCM) 39824.[3] In GCM 39824, the Chief Counsel held that the lump sum distribution authorities do not apply when determining whether there has been a "termination of service" under Code section 401.

Instead, GCM 39824 concluded three things. First, the controlled group rules of Code sections 414(b), (c) and (m) apply in determining whether someone has "terminated employment;" consequently, no severance occurs if an individual changes from one controlled group member to another. Second, a severance of employment does not occur if a new employer steps into the shoes of an old employer

[1] PLR 8614060 (January 9, 1986).

[2] Treas. Reg. § 1.401-1(b)(1)(i); *see also,* Rev. Rul. 56-693, 1956-2 C.B. 282, *modified by* Rev. Rul. 60-323, 1960-2 C.B. 148 (1960), which refers to a "severance from employment."

[3] July 6, 1990.

by taking "any portion of the employee's benefit" by virtue of a Code section 414(l) "transfer of assets or liabilities." Third, a severance of the employment relationship occurs even when the stock of a subsidiary is sold by a parent (even though there is no change in the common law employer of the employee), as long as three conditions are met. The pension plan must continue to be maintained by the original parent, and cannot be maintained by the subsidiary in the hands of the new owner. No assets or liabilities may be transferred to the subsidiary in the hands of the new owner or its controlled group. And, the subsidiary may no longer be in the original parent corporation's controlled group.

The approach in GCM 39824 is similar to the statutory rule for Code section 401(k) plans, but with one important difference. Under Code section 401(k)(10), distributions may be made upon a sale of assets or a subsidiary only if "the seller continues to maintain the plan." The section 401(k) regulations interpret this to mean that distributions may be made only if the buyer does not maintain the plan. The buyer is viewed as maintaining the plan if *any* individual participant's account is transferred under Code section 414(l) from the seller's plan to the buyer's plan. This "one transfer ruins all" approach is different than the one in GCM 39824, where the distributability of benefits is determined on an individual by individual basis. Thus, under GCM 39824, a distribution may not be made to anyone whose benefit is transferred to the buyer's plan in a Code section 414(l) transfer, but a distribution may be made to anyone whose benefits are not so transferred.

The precise legal rationale of GCM 39824 is difficult to discern. The GCM notes that a severance of the employment relationship is not determined simply on common law principles. For example, the GCM notes that the controlled group rules of Code sections 414(b), (c) and (m) must be applied in determining whether there is a severance from employment. While this proposition seems reasonable, it is a considerable leap then to conclude that continuity of plan sponsorship (i.e., whether assets are transferred) should decide the matter. Yet GCM 39824 makes this leap, citing Code section 414(l) as authority. Code section 414(l), however, merely deals with the minimum protections accorded liability transfers; it deals with the question of who is liable for benefits but it does not say when those benefits can be paid.

One would have expected the GCM to cite Code section 414(a)(1) for its statutory grounding. Code section 414(a)(1) requires a successor employer to credit service with its predecessor as long as the successor maintains the predecessor's plan.[4] In other words, section 414(a)(1) links the buyer and seller together if the transaction involves a transfer of assets, which is the same result as in the GCM.[5]

The theoretical underpinning of GCM 39824 is further clouded by the imputed compensation and service provisions included in the Code section 401(a)(4) nondiscrimination regulations. These regulations allow a plan to continue counting vesting, early retirement and benefit accrual service after a participant has been transferred to a successor employer in a sale, divestiture or joint venture and to count this service as service with the original employer for nondiscrimination testing.[6] These rules do not condition the link between buyers and sellers on whether assets have been transferred. As a result, it is a bit difficult to square the (a)(4) regulations with the GCM. In fact, these regulations are more consistent with the 1986 private letter ruling that the GCM disavowed.

Unfortunately, GCM 39824 and PLR 8614060 are about all the Service has had to say in this area. Curiously, the Service has decided not to issue a published ruling or regulations. Mainly because it is the latest word on the subject, many practitioners seem to view GCM 39824 as the definitive word, although it carries no

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[4] *See* PLR 9139023 (July 1, 1991). There, the Service held that an employer is treated as maintaining the plan of a predecessor employer if there was a transfer of assets and liabilities from the predecessor employer's plan to the successor employer's plan. The ruling dealt with determining "service with the employer for purposes of section 415."

[5] On the other hand, Code section 414(a)(2) does allow the IRS to issue regulations that would link the buyer and seller for service counting even if the successor is not maintaining the predecessor's plan. Of course, this result would be inconsistent with GCM 39824. At least one court has held, however, that until the IRS actually does issue these regulations, no service is required to be counted if plan sponsorship is not transferred. *Phillips v. Amoco Oil*, 614 F. Supp. 694 (D.C. Ala. 1985), *aff'd*, 799 F.2d 1464 (11th Cir. 1986), *cert. denied*, 481 U.S. 1016 (1987).

[6] Revenue Ruling 73-238, 1973-1 C.B. 193, suggests that this kind of service crediting violates the "exclusive benefit" rule of Code section 401(a)(2). The Service has recently indicated, however, that this aspect of the ruling will be reconsidered. IRS Notice 92-31, 1992-29 I.R.B. 6.

more weight than the 1986 private letter ruling. To date, GCM 39824 has been cited in only one case. A District Court cited it with approval in a case denying a benefit payout to an employee who was transferred from one controlled entity of an employer to another.[7]

[3] Early Retirement Eligibility-Entitlement Service

The 1986 private ruling and the 1990 GCM deal with the question of plan distributions. A corollary issue is whether early retirement entitlement service must continue to be recognized after the sale. The two results should mesh. If a plan distribution cannot be made because participants are working at the "same desk," those participants should continue to be credited with service. Nevertheless, the IRS has remained almost completely silent about service crediting, leaving the courts to try to sort things out.

[a] *PLR 9142027*

The only IRS authority dealing directly with the early retirement entitlement question is private letter ruling 9142027.[8] In this ruling, an employer who was participating in some sort of an association pension plan sold the assets of the business. Assets from the seller's plan were spunoff to the buyer's pension plan in a "de minimis spinoff" and a letter ruling was sought from the IRS on the question of early retirement eligibility service.

The parties wanted to disregard service with the buyer, so that the spunoff employees would not "grow-in" to early retirement subsidies after the spinoff. The IRS refused, and required that this service be counted. The Service did, however, look favorably on an alternative request. The seller was allowed to transfer assets equal to the accrued benefits to the buyer's plan, while keeping the early retirement subsidy in its own plan, as long as the seller counted service with the buyer for early retirement purposes. The seller, however, was permitted to stop recognizing service with the buyer if the buyer terminated the plan.[9]

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[7] *Pehr v. University of Chicago*, 799 F. Supp. 862 (N.D. Ill. 1992).

[8] July 22, 1991.

[9] It is not clear how the Service reached this result. The Service explained that this part of the ruling was granted

> since the period of service credited towards the early retirement subsidy under the proposed provisions of the Plan regarding service credited for employment

[b] *Hoechst Celanese* and *Hunger*

In contrast to the Service, the courts have had quite a bit to say on the early retirement entitlement issue. In *Gillis v. Hoechst Celanese Corp.*,[10] the buyer agreed to provide the same pension benefits as the seller. Although the facts are not well developed in either the Circuit Court's or the District Court's opinion, it is clear that the seller transferred assets and liabilities to the buyer's plan in a Code section 414(l) transfer.[11] The argument centered on whether service with the buyer must be counted toward early retirement eligibility with respect to the transferred benefits and, accordingly, whether the seller had transferred adequate assets to the buyer's plan to fund these benefits.

The seller took the position that the affected participants would not be entitled to "grow into" early retirement benefits after the sale, so that anyone ineligible for the subsidy at the time of transfer would never become entitled to the subsidy thereafter. The affected participants argued that the seller's failure to take into account the participants' early retirement/"grow-in" possibilities amounted to an impermissible cutback of accrued benefits under the seller's plan.

A divided Third Circuit ruled that the participants should continue to accumulate early retirement service credits while working for the buyer. First, the majority opinion found that the transfer of the pension plan and liability constituted a "plan amendment" bringing the "anti-cutback" rule of Code section 411(d)(6) into play.[12] The opinion next cited Revenue Ruling 85-6,[13] for the

with [the Purchaser] includes at least the minimum service required to be credited for vesting purposes under the Purchaser's Plan, which service does not have to include years of service for [the Purchaser] after termination of the Purchaser's Plan . . . .

10 4 F.3d 1137 (3d Cir. 1993), *cert. denied,* 128 L. Ed. 2d 46, 114 S. Ct. 1369, 1994 U.S. Lexis 2500 (1994).

11 The Third Circuit stated "we note that defendants contend that 'the amount of funds transferred [to the buyer's plan] was calculated to include the liability related to the 'Rule of 85' early retirement benefit' (Defs. Brief at 14). However, as the District Court correctly noted, whether defendants transferred sufficient assets to the [buyer's] plan to fund the early retirement benefits is a disputed factual issue."

12 Judge Seitz' majority opinion held that it was tantamount to an amendment for the seller to interpret the plan not to recognize service with the buyer as service for early retirement eligibility. Judge Alito's concurring opinion noted that the Code section 414(l) regulations require the plan sponsor to "hypothesize" a plan termination for the asset allocation requirement in a Code section 414(l) transfer

proposition that, even upon plan termination, the employer must make provision for employees who subsequently satisfy the pre-plan termination conditions for early retirement eligibility.

The opinion then quoted a passage from the legislative history of Code section 411(d)(6) in the Retirement Equity Act to the effect that early retirement subsidies may be eliminated if a participant has not met the qualifications for an early retirement benefit at the time of separation of service.[14] Concluding that the reverse is also true — that subsidies cannot be eliminated if there is no separation from service — the court noted the many instances where the phrase "separation from service" had been interpreted as a term of art in the Code. These authorities hold that a "separation from service" does not occur if the employee continues on in the same job for a successor employer.[15]

Based on these authorities, the Third Circuit broadly stated that "an employee is not separated from service if the employee continues on in the same job for a successor employer"[16] and held that the plaintiffs must continue to accumulate years of service while working for the successor employer. The Third Circuit assumed that the early retirement liability would remain in the seller's plan if insufficient assets were transferred[17] and remanded the case to the District Court for further consideration.

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of assets or liabilities, and that Revenue Ruling 85-6, 1985-1 C.B. 133, treats a "plan termination" as an "amendment."

[13] 1985-1 C.B. 133.

[14] The Retirement Equity Act Senate Report noted:

> [Section 301] generally protects the accrual of benefits with respect to participants who have met the requirements for a benefit as of the time a plan is amended and participants who subsequently meet the preamendment requirements. The bill does not, however, prevent the reduction of a subsidy in the case of a participant who, at the time of separation from service (whether before or after the plan amendment), has not met the preamendment requirements.

S. Rept. No. 575, 98th Cong., 2d Sess. 28 (1984).

[15] PLR 8614048 (January 9, 1986); PLR 9142027 (July 22, 1991); GCM 39384 (July 18, 1985) (dealing with distributions from a tax credit ESOP); Rev. Rul. 79-336, 1979-2 C.B. 187; Rev. Rul. 80-129, 1980-1 C.B. 87. For some reason, the Third Circuit failed to cite PLR 8614060.

[16] 4 F.3d at 1147.

[17] *Id.* Whether this can be done depends on whether the requirements of Code section 414(l) are satisfied. The answer to this may in turn depend on the type of "spinoff" under the Code section 414(l) regulations. *See* the text accompanying footnotes 29 to 36.

Although *Hoechst Celanese* cited a host of IRS authorities on the "same desk" rule, for some reason it failed to cite GCM 39824.[18] Nonetheless, the outcome in *Hoechst Celanese* is consistent with GCM 39824. While *Hoechst Celanese* centered on the question whether there was a "grow-in liability" and, secondly, whether this liability remained in the seller's plan or was transferred to the buyer's plan, it is clear that there was a Code section 414(l) transfer of the basic accrued benefits. The transfer of the accrued benefits alone, even without the "grow-in," is enough to block a separation from service under GCM 39824.

Careful consideration of GCM 39824, however, might have prevented the *Hoechst Celanese* court from making such sweeping statements on the separation from service doctrine. In particular, the court might have thought twice about its application of the lump sum "same desk" rule, which the GCM specifically concluded did not apply in this context. Arguably, however, the broad statements in *Hoechst Celanese* could be dismissed as dicta in any case that did not involve a transfer under Code section 414(l).

The second recent case involving early retirement eligibility service in the context of a divestiture was *Hunger v. The Pullman Company.*[19] Here, the seller sold the assets of a division, but did not transfer any part of its pension plan to the buyer in a Code section 414(l) transfer. The seller amended its pension plan to clarify that service with the buyer would not count toward early retirement eligibility. The Eighth Circuit disregarded the broad separation from service theory articulated in *Hoechst Celanese.* The court went on to distinguish *Hoechst Celanese* on the grounds that *Hoechst Celanese* involved a transfer of pension assets and liabilities, while *Hunger* did not. Moreover, the Eighth Circuit noted that even before the "clarifying amendment" the plan language in *Hunger* made it clear that eligibility service was based solely on service with the seller. Accordingly, the court held that service with the buyer need not be counted under the seller's plan.

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[18] It also failed to cite Revenue Ruling 86-48, 1986-1 C.B. 216, which is discussed in the text at footnote 30. This ruling does not address the "same desk" issue and whether "grow-in" service with the buyer must be recognized. Rather, it deals with the question of which plan may recognize the "grow-in" liability if it exists.

[19] 12 F.3d 118 (8th Cir. 1993), *cert. denied,* 1994 U.S. Lexis 4477 (1994).

There are a number of lower court decisions on the early retirement entitlement service issue, and the results are mixed. The most extreme of the lower court opinions, *Hollingshead v. Burford*,[20] was cited with approval by the Third Circuit in *Hoechst Celanese*. In *Hollingshead*, the court relied on the "same desk" rule to hold that post-sale service with the buyer should be counted under the seller's plan even though no assets or liabilities were transferred to the seller's plan. The *Hollingshead* court cited one of the published IRS lump sum distribution rulings.[21] It also pointed to the Retirement Equity Act legislative history stating that early retirement subsidies could be reduced after a "separation from service."[22] The court concluded that "separation from service" in this context means the same thing as it does in the lump sum distribution context.

The other lower court cases do not go quite as far as *Hollingshead* and are more consistent with *Hoechst Celanese* and *Hunger*. In *Berard v. Royal Electric, Inc.*,[23] a complicated situation involving three successive asset sales of the same business,[24] the court held that early retirement service with the buyer did not have to be counted under the seller's plan. The case did not involve a Code section 414(l) transfer.[25]

Likewise, in *Lear Siegler v. Smith Industries*,[26] the court held that employees of the seller who did not meet the age and service conditions at the time of the sale, which the court construed as a "termination of service," would not have service with the buyer counted toward early retirement in the seller's plan. *Lear Siegler* did not involve a transfer of plan assets and liabilities, and the

[20] 809 F. Supp. 906 (M.D. Ala. 1992).

[21] Rev. Rul. 79-336, 1979-2 C.B. 187.

[22] *See* footnote 14.

[23] 795 F. Supp. 519 (D. R.I. 1992).

[24] The seller originally contracted to transfer assets and liabilities in the sales agreement, but the buyer failed to satisfy the preconditions to the transfer. Accordingly, some two and one-half years after the sale, the parties settled the matter by agreeing that the buyer would not assume any of the liabilities in the seller's plan and the seller would not transfer any assets to the buyer's plan.

[25] Interestingly, the *Hoechst Celanese* court thought that *Berard* was contrary authority. However, *Berard* can actually be reconciled with *Hoechst Celanese* because it did not involve a Code section 414(l) transfer. Of course, this also makes *Berard* similar to *Hunger*.

[26] 1990 U.S. Dist. Lexis 2887 (S.D.N.Y. 3/16/90).

opinion suggests that this was the key fact. Specifically, the court noted that "an employee cannot 'grow-into' his right to a subsidy where he no longer works for the plan sponsor." Nonetheless, the outcome in *Lear Siegler* was surprising since the transaction involved the sale of stock of a subsidiary and not the sale of assets. The court concluded that the sale of stock of the subsidiary effected a termination of employment without discussing the particular wording of the seller's plan or citing any other legal authority.[27]

Curiously, none of the lower court cases cites the 1986 and 1991 private rulings or GCM 39824.

[c] *Ramifications of Hoechst Celanese* and *Hunger*

Clearly, the *Hoechst Celanese* and *Hunger* cases will affect how buyers and sellers bargain over the "grow-in" issue. The parties face a number of choices and problems. One option is for the seller to keep the plan (so that no assets are transferred) and stop counting "grow-in" service. Whether this can be done first depends upon the wording of the plan document. In some cases the participant will have an argument that the plan wording calls for recognition of the "grow-in" liability and that failure to follow the plan arguably constitutes an impermissible "cutback" of benefits.[28]

Even where the plan wording does not seem to call for additional service counting, there remains the question whether ERISA requires it. As noted, the legal landscape is ragged — GCM 39824 and *Hunger* stand in support of no "grow-in," while the 1986 private ruling and *Hollingshead* stand in opposition. The *Hoechst Celanese* case can be cited for both views — the broad rationale calls for

[27] The *Hollingsworth* court attempted to distinguish *Lear Siegler* as involving nothing more than a matter of contract interpretation. The issue in *Lear Siegler,* according to *Hollingsworth,* was not whether employees should be allowed to grow into their early retirement benefits, but rather which of two possible entities should have to pay for these benefits.

The case cannot be so easily distinguished. It is true that the *Lear Sigler* court held that under the contract language the seller's plan did not retain the "grow-in" liability for early retirees. It is not clear, however, from the wording of the sales agreement that the buyer agreed to assume the "grow-in" liability on the pre-sale accruals retained in the seller's plan. Nor did the *Lear Siegler* court reach such a conclusion. While the buyer's plan could have assumed this liability, the court had to analyze the case as if neither party had agreed to accept the liability.

[28] Note, however, the discussion in the text accompanying footnotes 39 to 46 for cases indicating that a Code section 411(d)(6) violation will not be found unless there is a plan amendment.

recognition of service with the successor, but it can be factually distinguished because it involved an asset transfer.

The second option is for the seller to transfer the plan to the buyer. Here there is very little room for argument regardless of the plan terms. All of the relevant authorities hold there is no separation from service and therefore require recognition of the "grow-in" liability. Since an impermissible cutback of the "grow-in" benefit could affect the qualification of both the sending and receiving plan, both buyer and seller face serious consequences if they decide to ignore the "grow-in" benefit.

A third option is for a seller to keep the "grow-in" liability in its plan, but transfer the rest of the accrued benefits to the buyer in a Code section 414(l) transfer. Can this be done under Code section 414(l)? If you merely look at the Code section 414(l) regulations, the answer seems to depend on whether the spinoff is a "general rule spinoff" or a "de minimis spinoff." Under a "general rule spinoff" all of the accrued benefits of each participant must be allocated to only one of the spunoff plans and assets not less than the value of benefits on a termination basis must be transferred to the spunoff plan.[29] Revenue Ruling 86-48[30] expands upon the Code section 414(l) regulations. It cites Revenue Ruling 85-6 for the proposition that early retirement subsidies are included in plan termination liabilities, and it concludes that the participants' "total benefit" — both accrued benefits and early retirement subsidies — must end up in one of the spunoff plans.

If the spinoff qualifies as a "de minimis spinoff," however, the same constraint is not found. Here the regulations do not refer to "benefits on a termination basis" and refer only to the value of the participant's "accrued benefit" in describing what assets must be transferred.[31] Accordingly, it appears that the "accrued benefit" and the "grow-in" liability can be separated in a de minimis spinoff. In fact, the literal wording of the regulations seems to allow *only* the accrued benefit, and not the early retirement subsidy, to be transferred from the original plan, since the regulation refers to the

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29 Treas. Reg. § 1.414(l)-1(m)(1).

30 1986-1 C.B. 216. Also, note the discussion accompanying footnotes 55–58, which deals with recent cases suggesting that only the "accrued benefits" are protected in a plan spinoff or merger.

31 Treas. Reg. § 1.414(l)-1(n)(2).

transfer of assets "equal to" the accrued benefit. This literal interpretation, however, is not supported by the instructions to the Form 5310.[32]

The question of splitting the "grow-in" liability and the accrued benefit has now been addressed in two private letter rulings.[33] The first was PLR 9142027, the same PLR that dealt with entitlement service in a "same desk" setting.[34] Since PLR 9142027 dealt with a "de minimis" spinoff, however, the bifurcation of the "grow-in" liability and the accrued benefits seemed consistent with the Code section 414(l) regulations. More recently, the Service approved the splitting of these benefits even in a spinoff that was not "de minimis." In PLR 9422059,[35] the Service acknowledged its long-held informal position that the Code section 414(l) regulations are merely a "safe harbor."[36] The ruling notes that "the basic rule that each participant receive benefits on a termination basis after a spinoff that are as great as such benefits before the spinoff can be satisfied even if only a portion of an individual's accrued benefit is spunoff from the plan." The Service found the requirements of Code section 414(l) satisfied since benefits on a termination basis were fully funded both before and after the transfer date.

PLR 9422059 raises some interesting possibilities for plan sponsors, extending to plan terminations as well as spinoffs. For example, employers often face problems annuitizing early retirement subsidies and ancillary benefits upon plan termination — the assumptions of the insurance carrier often are quite conservative. PLR 9422059 offers the possibility that this part of the benefit could be spunoff to another plan before a plan termination, so that only the accrued benefits would need to be annuitized.

[32] The instructions to Form 5310-A describe a "de minimis spinoff" as one where the "value of the assets spun off is not less than the present value of the benefit spunoff (whether or not vested)." Instruction A.4(a).

[33] These rulings explain the vague wording of Revenue Ruling 86-48 cited at footnote 30. In that ruling, the IRS stated that it "may" violate section 414(l) and the accompanying regulations if a plan is split into two plans and the "grow-in" liability and the joint and survivor liabilities are not taken into account in determining "benefits on a termination basis."

[34] *See* Footnote 8 and the accompanying text.

[35] March 11, 1994.

[36] For example, in PLR 8403086 (October 20, 1983), supplementing PLR 8324065 (March 15, 1983), the Service allowed the transfer of excess assets from an overfunded plan to an underfunded plan in the context of an employer that had filed for protection under Chapter 11.

[4] Code Section 411(d)(6) and Plan Amendments

The *Hoechst Celanese* case also has implications beyond the "same desk" context that are worth noting. In particular, the case is relevant to the question of the scope of the "anti- cutback" rule, and specifically, whether Code section 411(d)(6) protects only against plan amendments. Recall that the IRS has taken the position that Code section 411(d)(6) is violated if the plan gives the employer the discretion to decide payout forms.[37] The legislative history of the Retirement Equity Act also suggested that a plan provision that is triggered by some event could be viewed as a plan amendment at the time of the triggering event.[38]

The *Hoechst Celanese* case follows a series of recent cases holding that there must be an actual plan amendment before Code section 411(d)(6) applies.[39] Other cases have focused on this issue more precisely, but it is clear that the judges in *Hoechst Celanese* struggled to find that there had been a plan amendment when the buyer agreed to assume the plan,[40] thereby invoking Code section 411(d)(6). Among the cases where the amendment issue was the central focus was *Collignon v. Reporting Services Co.*[41] There, the court held that a plan provision giving the plan administrator discretion in the payout method — in that case lump sum or installments — did not violate Code section 411(d)(6). The court flatly noted that "[w]here there is no amendment altering the method of payment of benefits, the statute on its face does not apply."[42]

Other cases are in accord with *Collignon*. In *Dooley v. American Airlines, Inc.*,[43] the Seventh Circuit held that a change from fixed

[37] Treas. Reg. § 1.411(d)-4 Q&A 4.

[38] The Senate Report stated "of course, a plan provision that takes effect as a result of a change in the status of the plan from top heavy to non-top heavy would be treated as a plan amendment at the time the specified event occurs." Sen. Rept. No. 98-575, 99th Cong., 2d Sess. 30 (1984).

[39] Even if Code section 411(d)(6) is not violated in a particular situation, however, there still may be problems with the "definitely determinable" and "written plan" requirements, with Code section 411(b)(1)(G) and with the fiduciary provisions of ERISA.

[40] *See* Footnote 12.

[41] 796 F. Supp. 1136 (C.D. Ill. 1992).

[42] *Id.* at 1142.

[43] 797 F.2d 1447 (7th Cir. 1986), *cert. denied,* 479 U.S. 1032 (1987), and *cert. denied,* 479 U.S. 1087 (1987).

actuarial assumptions to floating actuarial assumptions, which affected the calculation of lump sums, was not an amendment reducing accrued benefits. The change in assumptions was authorized by a plan provision giving the plan administrator authority to change the actuarial assumptions from time to time. Likewise, in *Oster v. Barco of California Employees Retirement Plan*,[44] the Ninth Circuit found no Code section 411(d)(6) violation when the plan document gave the plan committee the power to grant or deny lump sum payouts. The committee made no actual changes in the provisions of the plan, it merely adopted a policy that applied to a provision that was already part of the plan.

Finally, a similar result also is found in *Stewart v. National Shopman Pension Fund*,[45] where certain past service credits were eliminated pursuant to a plan provision that was in place when the past service credits originally were recognized. The *Stewart* court stated that "[I]n its present form § 204(g) is specifically limited to *actual amendments,* not otherwise approved by ERISA, which would change benefit amounts."[46] ERISA does not, according to *Stewart,* say simply that an accrued benefit cannot be reduced.

[5] Drafters' Dilemmas

As noted, the law remains unsettled on the matter of plan distributions and early retirement "grow-ins" in the context of business sales and divestitures. Because these issues are so new, few plans have been drafted with clear answers in mind. Plan language tends to be vague, and it is difficult to interpret with any confidence. For example, whether a distribution is called for in a sale often turns on the definition of "employer" or "company." Sometimes, these definitions are drafted to include successors,[47] so there may be an argument that a termination of employment has not occurred after a divestiture. Moreover, many plans historically have approached sales and divestitures on a case-by-case basis and have allowed distributions or credited service in some cases but not

[44] 869 F.2d 1215 (9th Cir. 1988).

[45] 730 F.2d 1552 (D.C. Cir. 1984), *cert. denied,* 469 U.S. 834 (1984).

[46] *Id.* at 1563 (emphasis in original).

[47] Indeed, in the *Hunger* case, cited at footnote 19, the Eighth Circuit focused on the definition of the term "company" and concluded that the original wording of the plan did not call for continued service counting after the sale.

in others, notwithstanding the implications of the general plan provisions.

If one were drafting a plan from scratch, what would be the best way to handle these issues? Although the first impulse might be to include a GCM 39824-based provision in the plan to deal with the issue generally, this is probably not the best approach. For example, the wording that was blessed in the GCM calls for distributions from the seller's plan when "substantially all of the assets in a trade or business" are sold and there is no Code section 414(l) transfer to the buyer. With this sort of provision, the substantive rights of participants turn on how one interprets such vague terms as "trade or business" and "substantially all."

To avoid this problem, it probably makes sense broadly to prohibit plan distributions in "same desk" cases. The employer could then amend the plan in future sales situations to permit distributions on a case-by-case basis, taking into account the requirements of GCM 39824, if need be. Of course, this approach does not invoke Code section 411(d)(6) because these amendments would not be cutbacks. It may also make sense to take the same approach with "grow-in" service, i.e., to exclude the service generally and then to recognize it on a case-by-case basis. The "grow-in" service issue raises questions of the minimum requirements under Code section 411, however, so the IRS might object to this kind of plan provision.

Of course, most plan sponsors are not starting with a blank slate. For them, the most difficult situation will be when the plan arguably calls for distributions and "grow-in" service recognition in a sale or divestiture. Such a plan sponsor could find itself facing a true dilemma. The plan wording might call for plan distributions even where there is a Code section 414(l) transfer of assets and liabilities, and the sponsor might want to change the plan to satisfy the requirements of the GCM. Since an amendment making this change would be a prohibited cutback under Code section 411(d)(6), the plan could face disqualification if the change were made. Conversely, if the 1986 private letter ruling or the GCM is correct, the plan could face disqualification if the change were not made.

One would hope that the IRS will recognize this dilemma and will at least provide Code section 411(d)(6) relief to allow plans to be modified to meet whatever standards it articulates.[48]

There is a final twist to the drafting dilemmas created by GCM 39824. The GCM clearly contemplates that buyers and sellers will bargain over whether to transfer assets and liabilities to the buyer's plan. Suppose a plan includes a divestiture provision that allows distributions unless there is a Code section 414(l) transfer. If the parties in a particular transaction bargain over whether to transfer assets, which in turn would determine whether distributions were going to be made, the bargaining itself could theoretically be considered an exercise of impermissible discretion by the seller under section 411(d)(6) (at least under the theory that 411(d)(6) can be invoked without an actual amendment). Note also that under the 411(d)(6) regulations, an independent third party is treated as the employer's agent when it comes to exercising discretion under a plan,[49] so the employer would not be able to argue that bargaining with an independent purchaser somehow eliminates the question of discretion.

§ 10.03 PLAN TRANSFERS AND MERGERS

[1] Background

A number of recent cases interpret the provisions of ERISA section 208 and Code section 414(l). These sections provide that a plan may not merge or consolidate with another plan unless the participants would receive the same benefits upon a plan termination after the transfer or merger as they would have received on a plan termination before the transfer or merger. Since ERISA section 208 and Code section 414(l) hypothesize a plan termination, the question is which, if any, of the plan termination rules are read into these rules.

[2] *Kinek:* Full Funding in a Spinoff

Kinek v. Paramount Communications, Inc.[50] deals with whether benefits must be fully funded before a plan spinoff can occur. The case turned on the particular wording of the plan, but it raises the

48 The IRS has reserved the right to issue Code section 411(d)(6) relief. Treas. Reg. § 1.411(d)-4 Q&A 2(b).

49 Treas. Reg. § 1.411(d)-4 Q&A 5.

50 1994 U.S. App. Lexis 9210 (2nd Cir. 4/28/94).

question whether the same result would have been reached under the general rules of ERISA. The Second Circuit made a number of off-handed comments, seemingly contradictory and certainly dicta, that will serve as an invitation to future litigation and doubtless will prove confounding to future courts.

In *Kinek,* a single employer, collectively bargained defined benefit plan was spunoff to a new plan sponsor. The plan subsequently terminated with a significant asset shortfall, and the participants sued the original plan sponsor on the grounds that inadequate assets had been transferred in the plan spinoff. Participants claimed that the plan wording called for full funding at the time of the spinoff. They also argued that ERISA section 208 and Code section 414(l) required full funding of the spunoff portion of the plan.

The textual argument was based on reading two plan sections together. One was a standard recitation of the ERISA section 208 rule. The other section provided that upon termination of the plan "the employer will fully fund on a sound actuarial basis all vested benefits . . . ." In other words, the plan merger provision hypothesized a plan termination, as required under ERISA section 208 and Code section 414(l), and the plan also included a separate provision requiring full funding upon plan termination. The District Court said these two provisions should be read together. Because the participants would have been entitled to full funding of vested benefits if the plan had terminated before a spinoff, the participants were entitled to full funding of vested benefits at the time of the spinoff.

While the Second Circuit eventually upheld the District Court's opinion on the basis of the plan's wording, the court also analyzed the requirements of ERISA section 208 and Code section 414(l). This was not simply a matter of the Second Circuit going overboard; rather, the defendant argued on appeal that the textual (or contractual) interpretation was flawed because it was inconsistent with ERISA section 208. ERISA section 208, the defendants argued, hypothesizes a plan termination merely to invoke the priority rules of ERISA section 4044, thus basing its requirements on the extant plan assets. They insisted that any requirement of additional plan funding would be inconsistent with this scheme. The court was not convinced. It reasoned that section 208 cannot be read to prohibit that which it does not require, and concluded that a plan provision calling for additional funding is a permissible supplement to the ERISA funding rules.

Perhaps the most interesting, and potentially the most far reaching, part of the case dealt with the question whether ERISA section 208 would have required full funding on spinoff regardless of the plan terms. The defendants conceded that since 1986 ERISA has required all plans to be fully funded before a standard termination can occur, and thus that ERISA calls for the same kind of funding as required in Paramount's plan. Despite this full funding requirement, the defendants argued that the uniform and unquestioned practice since 1987 had not been to require full funding of benefits in a plan spinoff. Indeed, the defendants cited material from an Enrolled Actuary's meeting in which an IRS actuary had stated that Code section 414(l) requires an allocation of plan assets — ignoring any PBGC guaranteed benefits paid on top of existing assets and ignoring any funds that the employer would have to contribute in order to terminate a plan.[51]

The court's consideration of this issue was quite confused. The court first stated that it need not consider whether ERISA section 208 itself would require full funding. Nevertheless, it went on to include a footnote citing three cases for the proposition that full funding is required and one case for the proposition that it is not.[52] The court then added yet another footnote in which it seemed to agree with the PBGC's position that the ERISA termination rules, and specifically ERISA section 4041, do not require a plan to be fully funded at plan termination.[53]

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[51] "Mergers and Spinoffs," Margaret M. Warner and Paulette Tino, 1989 Enrolled Actuaries Meeting, 171, cited on pp. 26–27 of the Defendant-Appellant's-Cross Appellees Second Circuit brief.

[52] For full funding: *Gillis v. Hoechst Celanese Corp.*, 4 F.3d 1137 (3d Cir. 1993); *Koch Industries v. Sun Co.*, 918 F.2d 1203 (5th Cir. 1990); *Bigger v. American Commercial Lines*, 862 F.2d 1341 (8th Cir. 1988). No full funding: *United Steelworkers, Local 2116 v. Cyclops Corp.*, 860 F.2d 189 (6th Cir. 1988). The court's citation of *Hoechst Celanese* is especially curious on the matter of full funding. The *Celanese* case did not mention the funded status of the original plan. Accordingly, when the court concluded that additional assets should have been included in the plan transfer, it is unclear whether the situation would have involved an additional "top-up" contribution or whether the plan was overfunded and the case merely required an additional asset to be transferred.

[53] The PBGC argued that the ERISA section 4044 allocation rule includes all plan assets, including "all amounts due and owing a plan at termination." The PBGC noted that "Section 4041(a) and (b)(1)(D) of ERISA, as amended in 1987,

In addition to these contradictory footnotes, the Second Circuit confused the treatment of plan spinoffs and mergers. The court stated that a number of district court cases cited by the defendants should be disregarded because those cases involved plan mergers, rather than plan spinoffs. The court interpreted the Code section 414(l) regulations as requiring full funding of benefits upon plan mergers. It also said that, "since mergers and spinoffs are subject to different regulatory requirements," the "cases involving mergers are not necessarily useful in spinoff cases."[54]

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do not serve as a full funding clause for all plans upon termination." Brief of Appellee/Cross-Appellant Pension Benefit Guaranty Corporation at page 22. The PBGC noted as follows:

> Under current law, a plan sponsor can only terminate a fully funded plan in a "standard" termination under section 4041(b) of ERISA. But this is certainly not the equivalent of a requirement that all plans must be fully funded upon termination. In fact, the termination provisions of Title IV of ERISA say nothing at all about funding obligations. *See* 29 U.S.C. §§ 1341–1342 (1988 and Supp. IV 1992).
>
> Rather, a plan may be terminated by a plan sponsor with insufficient assets to pay its liabilities in accordance with certain distress criteria described in ERISA section 4041(c). 29 U.S.C. § 1341(c). Distress terminations can occur both within and outside of the context of bankruptcy, if all requirements are met. *See* 29 U.S.C. § 1341(c)(2)(B). Thus, the effect of the amendments to Title IV, which are in any event completely irrelevant to the instant case, is that an employer may not terminate a plan voluntarily unless it can either make good on all of its pension promises or demonstrate that it (and all members of its controlled group) are in financial distress (and even then only if termination would not violate the terms of an existing collective bargaining agreement). If a plan can neither terminate in a standard termination nor satisfy the distress test, then the plan must continue, unless PBGC exercises its discretionary authority under Section 4042(a) of ERISA, 29 U.S.C. § 1342(a) to terminate the plan involuntarily.

[54] In reaching the startling conclusion that the regulations require full funding of all accrued benefits upon merger, the court relied on the following language from Treasury Regulations section 1.414(l)-1(e)(1):

> if the sum of the assets of all plans is not less than the sum of the present values of the accrued benefit (whether or not vested) of all plans, the requirements of Code section 414(l) will be satisfied merely by combining the assets.

For some reason, the court did not quote the part of the regulation two sentences removed:

> However, if the sum of the assets of all plans is less than the sum of the present values of the accrued benefits (whether or not vested) in all plans, the accrued benefits in the plan as merged are not provided on a termination basis.

In this instance, the rules call for a special schedule of benefits. Treas. Reg. § 1.414(l)-1(f).

[3] Ramifications of *Kinek*

The issues raised in *Kinek* are sure to be revisited. Indeed, the court's discussion of ERISA section 208 stands as an invitation for subsequent plaintiffs to question whether full funding is required pursuant to ERISA sections 208 and 4041 regardless of the plan wording. The discussion also leaves something of a jumble for future courts. Although the PBGC took the position in *Kinek* that full funding is not required in a plan spinoff by operation of law, the IRS has yet to weigh in on the issue. The answer will affect pension portability, and it may take a legislative change to answer the question once and for all.

[4] *Malia:* Surplus Sharing in a Spinoff

Malia v. General Electric[55] is another recent circuit court opinion dealing with the plan merger rules and, in particular, with the scope of hypothesized plan termination under Code section 414(l). The case dealt with a contributory defined benefit plan with surplus assets, and the question was whether the benefits of the participants involved in the spinoff should be increased to account for the "surplus sharing" that would have occurred under ERISA section 4044(d)(3) if the original plan had terminated at the time of the spinoff. The Third Circuit held that "benefits" receivable upon a plan termination are different than the assets available under a plan at termination and that the hypothetical plan termination under Code section 414(l) is designed to deal only with asset allocation under ERISA section 4044. Accordingly, the Third Circuit held that the participants' benefits in the spunoff plan need not be increased because of the asset surplus.

Malia is particularly interesting, and may prove to be something of a problem, because of its discussion of what has to be funded in a plan spinoff. The Third Circuit upheld the District Court's holding that "benefits" under Code section 414(l) refers to "accrued benefits" only, "rather than including all benefits to which a plan participant would be entitled upon plan termination."[56] Revenue Ruling 86-48, in contrast, makes it clear that "grow-in" liabilities and joint and survivor subsidies, which technically are not part of

[55] 1994 U.S. App. Lexis 10686 (5/13/94).

[56] *Malia v. General Electric*, slip op. at 6-7 (E.D. PA. 1992).

a participant's "accrued benefit," are also involved in determining the minimum assets that must be transferred. The Third Circuit was trying to make it clear that the "surplus sharing" rule for contributory plans was not protected, but if Revenue Ruling 86-48 is correct, it is too narrow to say that only "accrued benefits" are involved. *Malia* is not the only recent case that has made this mistake; the same broad wording also appears in the *In re Gulf* litigation[57] and *VanOrman v. American Ins. Co.*[58]

§ 10.04 PLAN PROCEDURES

[1] In General

ERISA is a process oriented statute, and in a number of areas it requires that plans specify and follow certain procedures.[59] Plan drafters, however, tend to focus more on substantive provisions. As a result, plan procedures are not always carefully written, and in many cases simply do not exist. Over the past year, two circuit courts have underscored the risks this can involve. Although they deal with two very different kinds of procedures, these cases make it clear that having and following good procedures is serious business.

[2] Plan Amendments

[a] *Background*

ERISA section 402(b)(3) requires a plan to

> provide a procedure for amending such plan, and for identifying the persons who have authority to amend the plan . . .

This requirement applies to welfare and pension plans alike. Until recently, it has been pretty much ignored. Plan drafters typically are concerned more with the actual reservation of amendment authority than with who will exercise it or how. As a result,

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57 764 F. Supp. 1149, 1185 (S.D. Tex. 1991).

58 608 F. Supp. 13, 25 (D. N.J. 1984).

59 For example, all plans must have funding procedures. ERISA § 402(b)(1). In addition, ERISA permits plans to promulgate other procedures, which although optional, are still supposed to be followed. For example, delegations of fiduciary duties are supposed to be made only in accordance with written plan procedures. ERISA §§ 402(b)(3), 405(c)(1) and 405(c)(2).

amendment provisions often just reserve the right to amend to the "company," and say nothing at all about who within the company actually has this authority or how they are to exercise it.

The Third Circuit recently handed down a case that will probably change this. In *Schoonejongen v. Curtiss-Wright*,[60] the court invalidated an amendment to a welfare plan because the plan did not comply with the amendment procedures requirement. The decision is problematic in a number of respects, not the least of which is that it is likely to increase procedural challenges to plan amendments that employers thought they had properly reserved the right to make.

[b] *Curtiss-Wright: ERISA § 402(b)(3) Run Amok*

In *Curtiss-Wright*, an employer maintained a medical plan covering active and retired employees. The plan contained fairly typical language under which the "Company reserve[d] the right at any time and from time to time to modify or amend, in whole or in part, any or all of the provisions of the Plan."[61]

Up until 1983, the plan documents and SPDs indicated that retirees would continue to be covered until they "cease[d] to be a member of a class eligible" for benefits.[62] The underlying insurance policy listed a number of classes of employees entitled to benefits, two of which covered most retirees. This seemed to suggest that retiree coverage could be terminated only for the entire group.

In 1983, the SPD was revised to say that retirees would lose coverage if the facility from which they retired closed. Shortly thereafter, the company closed an operation, and announced that coverage would be terminated for those who retired from that facility. The affected retirees sued, claiming that they were entitled to lifetime benefits.

The District Court first rejected the company's argument that the change to the SPD was a clarification rather than an amendment.

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[60] 18 F.3d 1034 (1994). By normal convention the case should be referred to as the *Schoonejongen* case, but it has become known as the *Curtiss-Wright* case instead. We choose not to break ranks and will also refer to the case as *Curtiss-Wright*.

[61] *Id.* at 1037.

[62] *Id.*

It then noted that the company had effectively reserved the right to amend the plan, but went on to observe that there were no written amendment procedures, as required by ERISA. This failure was fatal, and the amendment was held invalid.

On appeal, the Third Circuit affirmed. The court began its analysis by looking at the purpose behind ERISA section 402(b)(3). According to the court, the amendment procedures requirement is intended

> to ensure that all interested parties will know how a plan may be altered and who may make such alterations. Only if they know this information will they be able to determine with certainty at any given time exactly what the plan provides.[63]

The court reasoned that the company's simple reservation of the right to amend did not serve this purpose and therefore did not satisfy ERISA.

The court then distinguished one of its earlier cases, *Huber v. Casablanca Industries, Inc.*[64] In *Huber,* the Third Circuit had blessed an amendment procedure virtually identical to the one in *Curtiss-Wright* except that the plan trustees rather than the company were given the power to amend. This time around, the *Curtiss-Wright* court thought the situation was different for two reasons. First, it concluded that " 'the trustees' clearly identifies the authorized persons, 'the company' does not."[65] In addition, the court found it significant that the *Huber* trustees had followed their own internal procedures in amending the plan. This part of the opinion ends with the observation that if the *Curtiss-Wright* plan had referred to the board of directors rather than the company, that might have been enough to sustain the amendment.

Having found a violation of ERISA section 402(b)(3), the court turned to the question whether this was enough to strike the

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63 *Id.* at 1038. On its face, this is a rather peculiar purpose to ascribe to the amendment procedures requirement. For most participants, the plan is an impenetrable legal document. The SPD is what is important. The Department of Labor regulations, however, do not require that the amendment procedures be spelled out in the SPD. DOL Regulations § 2520.102- 3. As a practical matter, participants are therefore unlikely to be aware of the amendment procedures no matter what the plan says.

64 916 F.2d 85 (3d Cir. 1990).

65 18 F.3d at 1039.

amendment. The court acknowledged the ERISA doctrine that substantive remedies for procedural defects are generally disfavored. It believed, however, that this doctrine should not apply to plan amendments, because something "fundamental" is at stake.

> The basic premise of ERISA is that a plan sponsor will be free to determine what benefits the plan will provide, but that once such a determination has been made, the benefits must be described in a written plan that is available to participants at any time upon request . . . . Unless and until the written plan is altered in a manner, and by a person or persons authorized in the plan, neither the plan administrator nor a court is free to deviate from the terms of the original plan.[66]

On this basis, the court concluded that the failure to satisfy section 402(b)(3) voided the amendment.[67]

The decision in *Curtiss-Wright* is troubling in several respects. While it may be difficult to argue with the conclusion that the plan violated section 402(b)(3), the court's analysis on this point is critically flawed. Moreover, even after it found a violation, there was ample authority under which the court probably should have refused to strike the amendment. Perhaps most troubling, it is likely that this case will end up being little more than a tool for plaintiffs to challenge plan amendments.

As noted, the court's argument essentially is that the plan amendment provision violated the purpose of ERISA section 402(b)(3). The court's analysis begins with the tautological proposition that the procedures requirement ensures that participants will know how and by whom their plan may be amended. The court concludes that this information is necessary so that participants will always be able to find out what the plan terms are.

This statement is somewhat vague. Presumably, it simply means that the procedures requirement helps prevent participant expectations from being defeated by unannounced changes in the plan. In effect, it operates like a disclosure rule, forcing changes to be made

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66 *Id.*

67 The court did recognize the Catch-22 it had created, by making a plan without proper amendment procedures unamendable forever. As a result, it specifically held that a plan without procedures could be amended solely to bring it into compliance with section 402(b)(3) by those who "possess the sponsor's final management authority." *Id.* at 1040.

above board. This is consistent with other judicial interpretations of section 402(b)(3).[68]

If this is what the court had in mind, however, its discussion of *Huber*, which is critical to the holding, is totally unconvincing. *Huber* involved the calculation of withdrawal liability under the Multi-Employer Pension Plan Amendments Act of 1980.[69] One of the issues was whether certain increases in benefits had to be recognized in calculating the withdrawing employer's liability. The increases had been unanimously approved by resolutions of the plan's board of trustees, and the resolutions had been noted in minutes signed and dated by the plan administrator. However, no formal plan amendments had actually been executed. The employer argued that this rendered the increases void (even though some of the increased benefits were in pay status).

The case first went to arbitration. The arbitrator noted that the plan gave board of trustees "broad powers to amend the plan, without limitations on the particular format of such actions."[70] He went on to observe that the employer had been perfectly aware of the increases as they had been implemented, and had never before objected to the lack of any formal amendment. On this basis, he concluded that the amendments were valid.

The Third Circuit upheld the arbitrator's finding. The court observed that the trustees had been given the power to amend the plan, and they had exercised this power at a regular board of trustees meeting and duly recorded it in meeting minutes. The court went on to hold that the plan provision was a procedure under ERISA section 402(b)(3) and that it had been followed.[71] The amendments were therefore valid.

In *Curtiss-Wright*, the Third Circuit's discussion of *Huber* can only be described as odd. In one sentence, the court conveniently disposes of its own precedent.

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68 *E.g., Adams v. Avondale Industries, Inc.*, 905 F.2d 943, 949 (6th Cir. 1990).

69 In addition to the Third Circuit's opinion, the case generated an arbitrator's decision, reported at 7. E.B.C. 2705, and an unreported district court opinion.

70 7 E.B.C. at 2739. For some reason, the arbitrator's opinion cites to two plan provisions for this proposition. The Third Circuit, on the other hand, cites to the unreported District Court opinion which refers to yet a third plan provision. 916 F.2d at 105 n.43. This is unimportant, however, because all three provisions gave the trustees broad powers to amend the plan, and none provided anything by way of procedures.

71 916 F.2d at 106.

> An individual reading the *Huber* plan could recognize the provision in question as describing a specific procedure for amending the plan; here, one is unable to tell what individuals or bodies within the Company could promulgate an effective amendment.[72]

This cursory treatment of *Huber* is flawed in three fundamental respects.

First, the *Curtiss-Wright* court does not explain why naming the plan "trustees" rather than the "company" gave *Huber* participants more protection from surprise amendments than *Curtiss-Wright* participants. It may be that the *Huber* plan named the individual plan trustees, so that the identity of those with amendment power was clear from the document. However, the published *Huber* opinions do not indicate whether this was the case, and if this fact had been important, the *Curtiss-Wright* court presumably would have pointed it out. In the absence of such a provision, it is very difficult to see why naming the "trustees" should make any difference.

More important, on its face, the provision in *Huber* hardly constituted a "procedure." In fact, the actual "procedures" were not in the plan at all. They were simply the internal procedures the board of trustees followed in conducting its business. In other words, the *Huber* court thought that ERISA section 402(b)(3) was satisfied as long as the entity with amendment authority followed its own internal procedures, even if those procedures were not in the plan. This was true even for procedures that did not include the requirement that plan amendments be formally adopted.

In this sense, the *Curtiss-Wright* plan arguably specified a "procedure" to the same extent as the *Huber* plan did. The "company" was given amendment power, and the company's normal decision making processes should have constituted its amendment procedures. In fact, the *Curtiss-Wright* court itself indicates what should have been the test. As long as the amendment was adopted by "those who possess the sponsor's final management authority," ERISA section 402(b)(3) should have been satisfied. In short, *Huber* did not involve a formal plan "procedure" any more than *Curtiss-Wright,* and cannot be distinguished on that basis.

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72 18 F.3d at 1039.

Finally, even assuming that the provision in *Huber* was uniquely a procedure, it is not a procedure that can be squared with the goal of helping participants avoid surprise amendments. The board of trustee's internal procedures were apparently not in the plan, and presumably were never otherwise disclosed to participants. It is almost otherworldly to suggest that compliance with these procedures would in any way ensure that plan participants always knew what the plan said. This seems especially true since the "procedures" allowed plan amendments without even the "formality" of execution. In other words, if the analysis in *Curtiss-Wright* is correct, *Huber* should not merely have been distinguished, but overruled.

Ultimately, the perfunctory dismissal of *Huber* makes the opinion in *Curtiss-Wright* a hard sell. The *Curtiss-Wright* court is forced to try to explain why it makes a difference to say the "trustees" or "board" rather than the "company" and in the process ends up looking a bit foolish. Undeterred, the court then turns to the question of the amendment's validity. Happily, the contrary authority on this point proves no obstacle at all. The court simply ignores it.

[c] *Biggers, Adams* and *Murphy:* A More Reasonable Approach

A number of courts have been faced with plans that violated section 402(b)(3). Unlike the Third Circuit, these courts have rejected the idea that the plans are per se unamendable. Instead, they have fallen back on the more general ERISA rule that substantive remedies are imposed for procedural defects only in extreme cases. These cases also articulate standards for evaluating how amendments should be made when there are no procedures and for determining the extreme circumstances under which it might be proper to invalidate an amendment.

In *Adams v. Avondale Industries. Inc.*,[73] an employer maintained an unwritten severance plan. Shortly before it sold off a division, it promulgated a written plan that denied benefits to anyone in the division who remained employed by the buyer. The case turned in part on whether the change was a valid amendment in light of the fact that the plan had no amendment procedures. The Sixth Circuit refused to find the plan unamendable, citing its belief that Congress did not intend such a result. The court suggested that it would

[73] 905 F.2d 943 (6th Cir. 1990).

impose this remedy only if the employees could show detrimental reliance on the plan's failure to have amendment procedures.

In *Biggers v. Wittek Industries, Inc.*,[74] an employer closed a facility and paid severance benefits in accordance with a new severance plan. Employees sued claiming that an older, more generous, plan was in effect. The issue came down to whether the employer had amended the older plan. Citing *Adams,* the court noted that the older plan was not unamendable merely because it had no procedures.[75]

The court went on to fashion a rule for determining whether a plan without procedures had been effectively amended. It looked to trust law and held that if the power to amend is reserved, the settlor can exercise it in any manner that "sufficiently manifests his intention to modify the trust."[76] Echoing *Adams,* however, the court concluded by warning that in some circumstances a plan without procedures might be unamendable.

Recently, a District court compared this line of cases with *Curtiss-Wright,* and concluded that the Seventh Circuit would not follow *Curtiss-Wright. Murphy v. Keystone Steel & Wire*[77] involved a medical plan that clearly violated section 402(b)(3). The plan sponsor amended the plan to change coverage for retirees. A group of retirees sued, citing *Curtiss-Wright* for the proposition that the amendment was void because it was made without proper plan procedures.

The District Court agreed that if *Curtiss-Wright* were persuasive, the company would have to lose. The court, however, was able to make a distinction that eluded the Third Circuit. The lack of an amendment procedure had been obvious from the SPD for many years, and the company had notified retirees of the change six months in advance. In addition, there was no allegation that "lack of an amendment procedure was done in bad faith, was actively concealed, or administered unfairly." Looking to *Adams* and *Biggers,* the court concluded that in these circumstances, the retirees

[74] 4 F.3d 291 (4th Cir. 1993).

[75] This issue was not actually before the court. The employees had not argued that the failure to have procedures made the plan unamendable. *Id.* at 295.

[76] 4 F.3d at 295 (quoting Restatement (Second) of Trusts § 330 comment i).

[77] 1994 U.S. Dist. Lexis 5890 (C.D. Ill. 5/2/94).

had not been harmed by the lack of an amendment procedure, even if they might have been harmed by the amendment itself.

This distinction was critical, and the court refused to void the amendment. Citing *Biggers*, it held that a plan that violated section 402(b)(3) nevertheless could be amended as long as there was a writing that clearly showed an intent to amend.[78] The court did add the warning that the lack of procedures could void an amendment in some cases, presumably if bad faith, concealment or unfair administration were shown.

Of course, this same reasoning could have been applied by the Third Circuit to the facts in *Curtiss-Wright*. The retirees in that case do not appear to have argued that they were harmed by the lack of procedures itself. It is telling that the court did not find *Biggers* or *Adams* persuasive in this situation.[79] Instead, the court steered conspicuously clear of these cases in what seems to be a single minded attempt to get where it wanted to be. Unfortunately, results driven analysis typically makes bad law, and *Curtiss-Wright* is no exception.

[d] *Ramifications*

Plan sponsors have already begun amending their plans in response to *Curtiss-Wright*. Many are simply giving amendment authority to the board of directors or to the plan administrator rather than to the company, since the opinion more or less sanctions this approach. Some are going a bit further and are adding minimal "procedures" to their plans (e.g., the amendment must be adopted at a duly authorized meeting by a majority of the board). In some cases, boards of directors are ratifying old amendments, although it is not entirely clear what sort of protection this will provide.

It is very difficult to see how any of these changes will advance the purpose the Third Circuit ascribes to section 402(b)(3). It seems

78 The requirement that the amendment be in writing is consistent with a long line of cases that reject oral modifications of ERISA plans. *E.g., Nachwalter v. Christie*, 805 F.2d 956 (11th Cir. 1986); *Moore v. Metropolitan Life Ins. Co.*, 856 F.2d 488 (2nd Cir. 1988).

79 In fact, in this portion of the opinion, the court cites only two cases, which stand for the proposition that if a plan *has* amendment procedures, they must be complied with. *Albedyll v. Wisconsin Porcelain Co.*, 947 F.2d 246 (7th Cir. 1991) and *Frank v. Colt Industries, Inc.*, 910 F.2d 90 (3d Cir. 1990). Neither case holds that a plan without procedures is unamendable, although *Frank* suggests this might be the case. *Id.* at 98.

ludicrous to suggest that the net result will be to reduce the likelihood that participants will be surprised by unexpected plan amendments.

On the other hand, at least one other court has said that the procedures requirement is designed to allow participants to "argue to— or challenge the decisions of— the person or entity making decisions about" benefits.[80] If this is right, section 402(b)(3) may not be just a disclosure provision. It may also be a provision to facilitate employee participation in the amendment process itself. Conceivably, the Third Circuit decided *Curtiss-Wright* with this goal implicitly in mind.

Viewed in this light, the opinion makes a bit more sense. There is some appeal to the idea that the board of trustees, or perhaps the board of directors, is a discreet identifiable body to which participants can turn if they wish to say something about a plan change. Still, it is not entirely obvious that the opportunity for participation would be significantly decreased if the "company" were given amendment authority instead. Presumably, it would not take much for an interested participant to find out that "company" means the board of directors or the plan administrator and to act accordingly.

Moreover, this analysis misses a more fundamental point. It may be hard in principle to dispute the goal of facilitating employee participation in the amendment process. In practice, however, it seems unrealistic to expect significant participation even if employees know exactly where the locus of amendment authority is. How many rank and file employees are actually willing to go to a board of directors meeting to voice their concerns about a plan amendment? In short, while perhaps a worthy goal, greater employee participation in the amendment process is hardly likely to be the practical result of *Curtiss-Wright*.

Of course, it may be that the court was simply trying to protect the retirees from what seemed like an unfair cutback, and whatever its merits, others will certainly try to use *Curtiss- Wright* to the same effect. Plan sponsors that have cutback benefits or terminated

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80 *Siskind v. Sperry Retirement Program*, 795 F. Supp. 614, 617 (S.D.N.Y. 1992).

plans[81] under faulty amendment procedures can expect to be routinely challenged under ERISA section 402(b)(3).[82]

To the extent *Curtiss-Wright* is persuasive, the result in these cases may turn simply on the recitation of magic words. If amendment power resides in the "board of directors," the amendment will probably survive. If amendment power resides in the "company," the result could be well different. To be sure, this is not the only instance under ERISA where a particular phrase has been imbued with inordinate significance, but it does seem to be one of the least defensible.

Unfortunately, as unsettling as this may be, it might not be the worst of it. The participatory theory in *Curtiss-Wright* dovetails nicely with another series of cases. These cases hold that it is a breach of fiduciary duty to mislead participants about changes to a plan.[83] The cases currently seem to draw the line at misrepresentation. They do not yet impose an active duty to disclose future changes.[84] However, it is not too far fetched to imagine a court synthesizing these cases and *Curtiss-Wright* to hold that ERISA section 402(b)(3) requires plan sponsors to disclose when they are

[81] A plan termination is just one kind of plan amendment. In theory, the procedural validity of a termination amendment would be analyzed like any other amendment. However, a court looking to void a termination presumably also could look to see whether any specific plan termination procedures had been followed. In Opinion Letter 80-22, the PBGC did exactly this. In that case, the plan administrator for a multiemployer plan filed a notice of intent to terminate. The PBGC refused to allow the termination, in part because the plan had not followed its termination procedures, under which only the employers, not the plan administrator, had the power to terminate.

[82] In fact, the opinion is already having an effect. In *Algie v. RCA Global Communications, Inc.*, 1994 U.S. Dist. Lexis 4735 (S.D.N.Y. 4/12/94), an employer was sued by participants in a severance plan who lost their jobs when their company was sold off. The participants claimed they were entitled to benefits under a prior, more favorable severance plan. A central issue in the case was whether the first plan had been terminated. The plan had standard language giving the company the power to "amend or terminate" the plan "at any time." No amendment or termination procedures were specified. Although it eventually decided the case on other grounds, the court took the opportunity to examine the plan's procedures in light of *Curtiss-Wright*. It called the analysis in *Curtiss-Wright* "compelling," and declared that in all likelihood no substantive modification could be made until proper amendment procedures had been put in place.

[83] *E.g., Fischer v. Philadelphia Elec. Co.*, 994 F.2d 130, 135 (3d Cir.), *cert. denied*, 126 L. Ed. 2d 586, 114 S. Ct. 622 (1993); *Berlin v. Michigan Bell Telephone Co.*, 858 F.2d 1154, 1163 (6th Cir. 1988).

[84] *E.g., Mullins v. Pfizer*, 1994 U.S. App. Lexis 9445 (2nd Cir. 5/2/94).

contemplating making changes to a plan. After all, meaningful participation would seem to be premised on this kind of notice.

Of course, participants in certain qualified plans are already entitled to 15 days advance notice of an amendment that significantly reduces future benefit accruals.[85] In fact, in *Davidson v. Canteen Corp.*,[86] the Seventh Circuit attributed a participatory purpose to this requirement. It said that the notice was intended to allow participants to attempt to "prevent injury from" an amendment. A court relying on *Curtiss-Wright* might conclude, however, that ERISA section 402(b)(3) requires even more — either in terms of the kinds of amendments that must be disclosed, the timing of the notice, or the circumstances under which the notice is required. For example, a court might find a duty to disclose a contemplated change as soon as it was reasonably likely to be made, and reasonably far enough in advance for participants to voice their objections. Although this may seem unlikely, there is no way at this point to know how the participatory theme in *Curtiss-Wright* and these other cases will develop.

Finally, *Curtiss-Wright* also may spill over to areas other than plan amendments. One likely place that this might occur is delegations of fiduciary duties. This is particularly true because the ERISA provision that requires delegation procedures, section 402(b)(3), is almost identical to the provision that requires amendment procedures. In fact, at least one court already has implied that a delegation of fiduciary duties could be void if it was made in violation of plan procedures.[87] If such a rule were ever actually applied, it would obviously keep the fiduciary on the hook for any actions taken under the voided delegation. However, it would also have another effect.

Under *Firestone Tire and Rubber v. Bruch*[88] many fiduciary decisions are reviewed by a court under the arbitrary and capricious standard as long as the fiduciary is given the discretionary authority to interpret the plan. The decisions of a fiduciary's delegate are

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[85] ERISA § 204(h). This provision only applies to cutbacks under defined benefit plans and defined contribution plans subject to the minimum funding standards. It does not apply to welfare plans. Moreover, it only requires notice before an amendment becomes effective, not before it is adopted.

[86] 957 F.2d 1404 (7th Cir. 1992).

[87] *Andersen v. CIBA-GEIGY Corp.*, 759 F.2d 1518 (11th Cir. 1985), *cert. denied*, 474 U.S. 995 (1985).

[88] 489 U.S. 101 (1989).

accorded the same deference. However, if a delegation were voided under a procedural defect theory, the delegate's decisions would be subject to de novo review if challenged in court.[89]

[3] Qualified Domestic Relations Orders

[a] *Background*

ERISA section 206(d)(3)(G)(ii) requires all qualified plans to:

> establish reasonable procedures to determine the qualified status of domestic relations orders and to administer distributions under such qualified orders.[90]

Like the amendment procedures requirement, this rule has not always been taken too seriously. Many plans do not have any written procedures. Those that do may still review and administer QDROs on an ad hoc basis. But here, too, a recent case may shake things up.

In *Schoonmaker v. Employee Savings Plan of Amoco Corp.*,[91] the failure to comply with written QDRO procedures proved quite costly for a plan. Perhaps because of its unusual facts, this case has not received widespread attention. It does, however, have some important implications.

[b] *Schoonmaker: What you Say is What You Do*

In *Schoonmaker,* a defined contribution plan had formal QDRO procedures that required a hold to be put on participant accounts after the plan received a proposed QDRO. The procedures were silent about a freeze before an order had been received. Under an informal practice, however, holds were placed on accounts when a proposed QDRO was in the offing. Pursuant to this practice, a hold was placed on a participant's account after the plan administrator became aware that an order was going to be presented.

[89] *Madden v. ITT Long Term Disability Plan*, 914 F.2d 1279 (9th Cir. 1990), *cert. denied,* 498 U.S. 1087 (1991); *Rodriguez-Abreeu v. Chase Manhattan Bank*, 986 F.2d 580 (1st Cir. 1993).

[90] The Code contains an identical requirement. Code § 414(p)(6)(B). This means that, unlike the amendment procedures requirement, the specter of disqualification always lurks in the background where there is a failure to comply, at least theoretically.

[91] 987 F.2d 410 (7th Cir. 1993).

In the meantime, the participant tried to sell some stock that was being held in his account and have the proceeds deposited in the plan's money market fund. The hold prevented these transactions from being processed. All of this occurred just before the October, 1987 stock market crash, and apparently the stock the participant tried to sell plummeted in value while the hold was in effect. The participant later sued the plan, seeking to have his account restored to what it would have been if the transactions had been processed as requested.

The Seventh Circuit found the plan liable. The court concluded that the hold violated the plan's written procedures and therefore ERISA's requirement that QDROs be administered in accordance with established procedures. It rejected the District Court's conclusion that the informal hold was allowed under a reasonable interpretation of the plan's QDRO rules. In passing, the court did observe that the informal hold, "which was developed to protect Plan beneficiaries and to minimize liability to the Plan, was reasonable."[92] The only problem was that the written procedures themselves did not allow it.

[c] *Ramifications*

In one respect, *Schoonmaker* bears a resemblance to *Schoonejongen v. Curtiss-Wright,* other than the improbable similarity in the plaintiffs' names. Like *Curtiss-Wright, Schoonmaker* involved the somewhat mechanical application of a procedural rule. While the court recognized that the hold was reasonable, it nevertheless held the company to the literal terms of its procedures. Of course, it may be that the Seventh Circuit, like the Third Circuit, was simply driven by a desire to reach the "right" result. In *Schoonmaker,* however, it is a bit harder to quarrel with the outcome.

The kind of hold that the plan put on the participant's account was unusual and probably unnecessary. A freeze on investment directions only protects an alternate payee from a participant who maliciously or incompetently destroys the value of his or her account during the relatively brief period of time a hold is in effect (typically a matter of months). As a practical matter, most participant directed plans simply do not offer investment alternatives that are volatile enough to make this likely. Moreover, the assumption

[92] *Id.* at 413.

that a participant will purposely destroy his or her account seems questionable in all but the most acrimonious situations.

Since the freeze was a questionable practice in the first place, it is perhaps not surprising that the court let the company bear the brunt of its effect in this unusual situation. It also does not seem objectionable in principle to require the plan to follow written procedures if it wants to freeze accounts.

In any event, *Schoonmaker* underscores the need to draft and to follow carefully written QDRO procedures, which include hold rules. Holds are critically important to proper QDRO administration because they help minimize any risk that a plan will have to pay the same benefit twice.[93] However, holds can be tricky, as *Schoonmaker* demonstrates. There are at least three issues that should be considered in deciding when and how to impose them. For better or worse, there is little guidance in this area, so plan sponsors will be more or less on their own.

The threshold issue is at what point does a plan administrator have the authority to restrict a participant's rights, pending receipt of a QDRO. Listed below, in decreasing order of formality, are the various points at which a plan administrator may have notice that a QDRO is pending:

Receipt of an order issued by a court.

Receipt of a draft order.

Rejection by the plan of a draft order or order.

Written notice (from one or both parties) that a QDRO is pending.

Oral notice (from one or both parties) that a QDRO is pending.

There is little doubt that a hold would be appropriate in the first three situations. The harder questions arise in the fourth and fifth situations. A hold probably would be appropriate if the plan administrator received written notice from both parties. Oral notice from both parties could also warrant a hold, but perhaps one of

[93] Arguably, a plan *must* have a hold provision to protect the ERISA rights of alternate payees.

shorter duration. The trickiest question is whether written or oral notice from only one party should be accorded the same treatment. As noted, there are no hard and fast rules here, so plan administrators will have some latitude in deciding how to draft their procedures.

The second area that good QDRO procedures should spell out is the effect of a hold. The considerations in this area are somewhat different for defined benefit plans than they are for defined contribution plans.

In defined contribution plans, *Schoonmaker* effectively teaches that holds should not extend to investment directions. The risk this is designed to minimize is probably overrated. On the other hand, holds probably should extend to loans and all other distributions (in-service or otherwise).

In defined benefit plans, the analysis may vary depending on whether the benefit is in pay status. A benefit that is currently in pay status should probably not be held in the absence of anything less than a signed court order. A benefit not currently in pay status could probably be held on something less. Of course, loans and in-service distributions typically will not be a problem.

The last main issue that needs to be considered is the duration of the payout hold. The procedures should probably establish some fixed period during which the hold will be effective, and after which the hold will be lifted in the absence of an actual or draft order. The length of the period could vary with the kind of notice the plan administrator had. For example, the plan might impose a 90 day hold on written notice from both parties that a QDRO was forthcoming, but only a 30 day hold on oral notice. Again, there are no specific rules here, so there will be some latitude.