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Who is entitled to subsidized early retirement benefits when a pension plan is terminated?

by Jay E. Grenig

The Mead Corporation
v.
B. E. Tilley, et al.
(Docket No. 87-1868)

Argument Date: Feb. 22, 1989

ISSUE

Before a pension plan's surplus assets may revert to the employer, does the Employee Retirement Income Security Act ("ERISA"), 29 U.S.C. § 1344, require the employer to pay subsidized early retirement benefits to employees who had not qualified for early retirement at the time of the plan's termination?

FACTS

B. E. Tilley and five other former employees of a subsidiary previously owned by the Mead Corporation sued Mead for refusing to award them unreduced subsidized early retirement benefits, even though they had not satisfied the requisite age and service pension plan's requirements at the time the plan was terminated in 1983. Mead's retirement plan was a non-contributory, defined benefit plan, which provided three types of benefits based on a participant's age, earnings, and years of service at retirement or other termination of employment.

The plan's normal retirement age was 65. However, participants who had completed 30 years of service and elected to retire on or after reaching age 62 were entitled under the plan to an unreduced (or subsidized) early retirement benefit equal to the amount normally payable at age 65.

When Mead sold the subsidiary and terminated the plan, it severed the employment of the subsidiary's employees. All plan participants who had satisfied the plan's age and service requirements for early retirement at the time of the plan's termination received their unreduced early retirement benefits.

Because Tilley and the other five plaintiffs had not satisfied the plan's age and service requirements for early retirement, they received the actuarial equivalent of their normal retirement benefits payable at age 65 based on their completed years of service on the date of the plan termination.

After the payment of all benefits and other liabilities, there was $10,799,000 left in the plan's fund. The Pension Benefit Guaranty Corporation (PBGC) and the IRS determined that the plan's assets were sufficient to pay out all legally required benefits and that reversion of the surplus to Mead was proper under Title IV of ERISA.

In 1984 Tilley and the other five plaintiffs challenged the reduced benefit calculations, alleging that under ERISA they were entitled to the unreduced, subsidized amount payable at age 62.

The U.S. District Court for the Western District of Virginia held that the reversion of the surplus assets to Mead was authorized by both ERISA and the plan. On appeal the U.S. Court of Appeals for the 4th Circuit reversed the district court, ruling that upon the plan termination, ERISA Section 4044(a)(6) prohibited reversion of any plan assets to Mead until it had paid early retirement benefits to the employees "even if those benefits were not accrued at the time of termination." 815 F.2d 989 (4th Cir. 1987).

The 4th Circuit held that the plaintiffs' benefits "should be determined by figuring the actuarial reduction of five percent per year from the early retirement age of the [employee], rather than from age sixty-five."

BACKGROUND AND SIGNIFICANCE

More than 60 million participants are covered by 870,000 private retirement plans with almost $1.5 trillion in plan assets. ERISA provides a comprehensive federal regulation of private pension and other employee benefit plans. Many of the covered pension plans are what are referred to as "defined benefit plans." The benefits received by employees under a defined benefit plan are fixed and the employer's contribution is adjusted to whatever level is necessary to provide those benefits.

To determine the amount of its required annual contribution, the employer selects a funding method that typically contains actuarial assumptions about such things as salary increases, mortality and turnover of employees, and investment return on plan assets. The employer assumes the entire risk if actual plan experience results in insufficient assets to pay benefits earned under the plan. The employee's defined benefit is unaffected by whether plan investments are good or bad.

The opportunity for an employee to receive unreduced benefit payments sooner than the normal retirement age is referred to as a "subsidized" early retirement benefit. Many

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defined benefit plans provide a subsidized early retirement benefit.

When a defined benefit plan terminates, plan assets may either exceed or fall short of benefits earned under the express terms of the plan. If the plan has been generously funded, or has enjoyed more favorable experience than its actuaries assumed, or both, surplus assets will exist.

Pension plan terminations involving more than $45 billion in assets and more than $16 billion in employer reversions occurred from 1980 through June 30, 1987. This surplus resulted from several factors, including the surge in interest rates in the 1970s and in stock prices in the 1980s. Because of an increasingly competitive business environment, employers were forced to use available funds more efficiently. Leaving a surplus in a pension plan where it would not be needed and would not benefit anyone became unaffordable.

In making its decision regarding the allocation of benefits at the time of the plan's termination by Mead, the 4th Circuit relied on *Amato v. Western Union International*, 773 F.2d 1402 (2d Cir. 1985), *cert. dismissed*, 106 S. Ct. 1167 (1986). In *Amato* the 2d Circuit stated that unaccrued early retirement benefits constituted "other benefits under the Plan" within the meaning of ERISA Section 4044(a)(6), and that such benefits must be considered in determining the value of an employee's benefit upon termination of the plan.

The 11th Circuit recently ruled that awarding "benefits for anticipated future years of employment which have not actually been and may never be worked" would enable employees to get something for nothing. *Blessitt v. Retirement Plan for Employees of Dixie Engine Co.*, 848 F.2d 1164 (11th Cir. 1988). The court distinguished *Amato* and the 4th Circuit's decision in this case, stating that the benefits sought in *Blessitt* were mere benefit expectations while the benefits sought in *Amato* and this case were earned.

Prior rulings and interpretations by the Pension Benefit Guaranty Corporation have construed ERISA Section 4044(a) to include only those benefits that have accrued under the terms of a plan as of the date of plan termination. However, Department of Treasury regulations define "liabilities" for purposes of termination of pension plans as including both fixed and contingent obligations to employees.

If the Supreme Court rules in favor of the employees, its decision could call into question nearly 100,000 single and multi-employer retirement plan terminations since the enactment of ERISA in 1974, and provide employees covered by those terminated plans with increased benefits. While such a decision might dissuade some employers from establishing new defined-benefit pension plans, it also could discourage employers with defined-benefit pension plans from terminating the plans in order to recover the surplus.

ARGUMENTS

For the Mead Corporation *(Counsel of Record, Charles J. Faruki, Smith & Schnacke, P. O. Box 1817, Dayton, OH 45401-1817; telephone (513) 443-6734):*

1. ERISA did not change the rules permitting the reversion of surplus assets to an employer upon the termination of a defined benefits plan.
2. Partial satisfaction of the requirements for receiving subsidized early retirement benefits creates neither accrued benefits nor contingent liabilities payable upon plan termination.
3. Because the plan's surplus assets resulted from "actuarial error" resulting in investments more financially favorable than the projected experience utilized in the funding, the reversion to Mead was proper.

For B. E. Tilley *(Counsel of Record, Edwin C. Stone, Stone & Hemrick, P.C., P. O. Box 2968, Radford, VA 24143; telephone (703) 639-9056):*

1. ERISA did nothing to change the long-standing rule that the contingent benefit must be satisfied prior to the termination of a trust fund.
2. Mead is asking the Court to grant it a windfall so that it may recoup funds set aside in the plan for early retirement benefits.
3. ERISA requires that the funds earmarked for early retirement benefits be paid before the employer may recoup any funds.

AMICUS BRIEFS

In Support of the Mead Corporation

The Pension Benefit Guaranty Corporation and the National Employee Benefits Institute argue that ERISA Section 4044(a)(6) requires the allocation of the assets of a terminated plan only to benefits accrued under the terms of the plan at the date of the plan's termination or required to be provided by Titles I and II of ERISA.

According to the Chamber of Commerce of the United States, a decision against Mead would dismantle ERISA's carefully crafted priority system for distributing assets of terminated pension plans.

The American Society of Pension Actuaries contends that upholding the 4th Circuit's decision would make it difficult for pension administrators and actuaries to complete plan terminations.

Noting that the determination of an appropriate amount of damages in a case such as this is a highly complex actuarial matter that was neither briefed nor argued extensively by the parties below, the American Academy of Actuaries asks the Supreme Court to return the issue of damages to the lower courts for further consideration.

In Support of B. E. Tilley

The American Association of Retired Persons argues that an early retirement subsidy is an accrued benefit for purposes of ERISA's anti-cutback rule. This rule prohibits an employer from reducing or eliminating an accrued benefit by amending or terminating the plan.

The AFL-CIO asserts that the subsidized early retirement benefit is a contingent liability that the Mead plan must pay on termination of the plan.