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Reversal of Fortune -- The "New and Improved" Abandoned Plan Rule - Part I

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There is something both heartwarming and inspiring when the federal government admits it made a mistake and then takes action to correct it. Some five years ago, the U.S. Department of Labor ("DOL") announced what appeared to be a helpful rule for "abandoned" 401(k) plans. Shortly thereafter, the DOL proceeded to interpret the abandoned plan rule into irrelevance. As originally announced, the final "abandoned plan" rule and prohibited transaction class exemption provides a streamlined process for winding up the affairs of abandoned individual account retirement plans (which include 401(k) plans). 29 C.F.R. § 2578.1. The DOL's initial take on the rule was that it did not apply to abandoned 401(k) plans supervised by liquidating bankruptcy trustees. The DOL's position was that only 401(k) plans having no plan sponsor and having no liquidating bankruptcy trustee were permitted to use this rule.

Even though the final rule listed "bankruptcy liquidation" as one of the factors for determining "abandoned plan" status, bankruptcy trustees were precluded by the DOL, by fiat, from using the "abandoned plan" rule. On May 26, 2011, the DOL reversed course. The DOL announced it was expanding the "abandoned plan" rule to include liquidating bankruptcy trustees. It reasoned that using the abandoned plan rule in bankruptcy liquidations has the potential to substantially reduce burdens on abandoned plans, their participants and bankruptcy trustees (includes chapter 7 and chapter 11 trustees).

Unfortunately, the DOL's new rule will not extend the abandoned plan rule to receivers and other fiduciaries (collectively hereafter "fiduciary" or "fiduciaries"). If the "abandoned plan" rule is unavailable, a plan fiduciary must take the long, labor-intensive road to terminate the plan and eventually distribute its assets to the plan's participants. A "standard" 401(k) plan termination may take two years or more. If the receivership appointment order requires the receiver to "continue to perform the obligations required of the administrator," and wind up the plan due to the plan sponsor's insolvency, the receiver will be required to take control over the plan. Winding up the plan's affairs in a liquidation is no easy task. The list of chores this retirement plan obligation covers is quite long. For example, the receiver or trustee must locate missing employee contributions, missing loan repayments, prepare missing annual Form 5500 filings, etc. The trustee or receiver must also cooperate with the DOL, who may investigate the plan due to missing employee contributions or other participant complaints. CPA audits may need to be prepared for missing IRS Form 5500 reports (annual 5500 reports are required if there were more than 100 participants at the beginning of the plan year). If difficulties occur, do not hesitate as the fiduciary to obtain additional instructions from the appointing court in order to potentially limit exposure to potential risks as much as possible.

This article contains a summary of the steps bankruptcy trustees, receivers or fiduciaries must take (without the benefit of the abandoned plan rule) to wind up the affairs of a 401(k) plan.

Involuntary Servitude for Bankruptcy Trustees and Receivers

Liquidating bankruptcy trustees are required to "continue to perform the obligations required of the [plan] administrator" (discussed below) when assigned to a case containing an ERISA-regulated employee benefit plan. Orders appointing receivers may have similar requirements. The bankruptcy trustee or receiver is thus in a classic "Catch 22" situation. He or she is obliged to pay the plan's service providers, deal with participant problems and wind up the affairs of the plan – all pursuant to 11 U.S.C. § 704(a)(11), but the bankruptcy estate cannot ordinarily be charged for these services. This "work with no pay" requirement creates numerous problems. By law, the pension plan is a separate legal entity distinct from its bankrupt plan sponsor. 29 U.S.C. § 1132(d). It is often difficult (but not impossible) to get court direction regarding 401(k) plan issues. Given these circumstances, a receiver or fiduciary should make sure that some form of compensation is granted in the appointment order prior to assuming the required duties. The plan documents usually state that counsel and the other plan service providers are allowed (within reason) to be paid from the plan's assets See, 29 U.S.C. § 1108(b)(2).

Pursuant to the new abandoned plan procedure (discussed in the next issue of RN), however, a liquidating trustee will be allowed to pay itself for services from the plan's assets, upon court approval of its fees and expenses.

Bankruptcy's Limbo for 401(k) Plans

As young Catholics, we were taught that limbo was a nether region located somewhere between heaven and hell for people not good enough to go to heaven, but not bad enough to go to hell. For bankruptcy trustees, life under 11 U.S.C. § 704(a)(11) seems much closer to hell than limbo. Here is why. For the past five years, the DOL has harassed and harried any bankruptcy trustee who attempted to use the abandoned plan rule. *See, e.g., In Re Mid-States Express, Inc.*, 433 B.R. 688 (Bankr. N.D. Ill. 2010), where the bankruptcy court (agreeing with the DOL) ruled that it did not have jurisdiction over a bankruptcy trustee's acts in terminating a 401(k) plan. Commendably, the DOL's announcement returns the abandoned plan rule to the place where it belongs – the land of lost 401(k) plans. Without use of the abandoned plan rule, the Bankruptcy Code placed bankruptcy trustees in a "limbo-like" situation. Some bankruptcy courts found that administration of a debtor's 401(k) plan falls outside the bankruptcy court's jurisdiction (*Mid-States, supra*); while others ruled a bankruptcy trustee's 401(k) plan administration was subject to Bankruptcy Court jurisdiction. *In re The Robert Plan Corp*., 439 B.R. 29, 42 (Bankr. E.D.N.Y. 2010). Bankruptcy Code Section 704(a)(11) is itself not a model of clarity. It states:

> The trustee shall —
> (11) if, at the time of the commencement of a case, the debtor (or any entity designated by the debtor) served as the administrator (as defined in section 3 of the Employee Retirement Income Security Act of 1974) of an employee benefit plan, continue **to perform the obligations required of the administrator;**[1]

In the cases cited above, the DOL maintained that a bankruptcy trustee was the Plan Administrator by operation of 11 U.S.C. § 704(a)(11) because the debtor company was the Plan Administrator at the time the bankruptcy proceeding was commenced. According to the DOL, if the plan had a Plan Administrator, it could not be abandoned. Yet the court in *In re The Robert Plan* found that plain language of this Bankruptcy Code section, as well as the context of the bankruptcy trustee's responsibilities arising under 11 U.S.C. §704(a)(11), make clear that continuing "to perform the obligations required of the administrator" is not the same as being deemed the ERISA "Plan Administrator" by operation of law. Prior to the May 26, 2011 change in the abandoned plan rule, the Department of Labor had consistently maintained that chapter 11 bankruptcy trustees were ERISA Plan Administrators by operation of § 704(a)(11) because the debtor had been the Plan Administrator at the time the bankruptcy proceeding was commenced.

The argument against the DOL's position is as follows. If Congress had intended to appoint bankruptcy trustees to act as ERISA Plan Administrators, it would have said just that in 11 U.S.C. § 704(a)(11), but it did not. Instead, § 704(a)(11) only directs bankruptcy trustees to "continue to perform the obligations required of the administrator." This is not an artificial distinction. Although a bankruptcy trustee performs some obligations of the debtor, the debtor and the bankruptcy trustee remain two separate legal entities. The statutory phrase "continue to perform the obligations required of the administrator" indicates that Congress wanted the bankruptcy trustee to continue to "administer" the ERISA plans by making plan benefit payments, reviewing claims for benefits, etc., during the bankruptcy. Nothing in this statutory language indicates that the bankruptcy trustee "steps into the shoes of the Company" for other ERISA purposes. A bankruptcy trustee is, at most, a limited purpose ERISA fiduciary according to this statutory language.

A Liquidating Bankruptcy Trustee's Experiences

The dilemma created by § 704(a)(11) for a liquidating trustee prior to the recent expansion of the abandoned plan rule can be seen from the following case study. A 401(k) plan was present in a case with initially over 100 participants and in excess of $1,000,000 of plan participants' funds on deposit. Employees of numerous companies in a corporate group were a part of the plan, but only about one-half of the companies had actually adopted the plan in accordance with DOL and IRS rules for conformance of documentation. No original signed plan documents could be located either at the debtors' offices or the pension plan Investment Manager's office. To make it more interesting, certain trust funds deducted from employees' checks did not make it into the plan, and the bankruptcy trustee had access only to the payroll records applicable to the companies within her chapter 11 bankruptcy case. What was the poor trustee to do, besides hope that the abandoned plan rule (proposed by the author Mr. Baker himself) would be extended to liquidating bankruptcy trustees!

Terminating a 401(k) Plan Outside of the Abandoned Plan

Absent the use of the "abandoned plan" regulation and its companion class exemption, the following steps should be taken to terminate an individual account plan (like a 401(k) plan). The Plan could be wound up using the method described below within six to nine months if an application for a favorable determination at termination (Item #3) is not filed.

1. *A Resolution by the Plan Sponsor to Terminate the Plan* – Review the plan document to identify what the Plan says about how the plan can be terminated. An appropriate resolution must be adopted terminating the Plan as of a date certain. The resolution terminating the Plan must also indicate that all participant accounts are immediately 100% vested as IRC § 411(d)(3) requires Plan participant accounts to be 100% vested on the date of Plan termination.

2. *Adopting Necessary Plan Amendments* – Are amendments needed to conform the Plan to recent changes made to the Tax Code? If yes, conforming amendments should be adopted. Many retirement plans are prototype plans drafted and maintained by mutual fund or insurance companies. Identify the Plan's author. If the plan drafter is unknown, it may be less expensive to simply file an application to the IRS Voluntary Correction Program (VCP) to recognize the Plan as an "Orphan" Plan. See Revenue Procedure 2006-27. Depending on when the Plan was last updated, it may be that no additional corrective amendments need to be made. The "Orphan Plan" procedure allows the "interim" Plan sponsor to make required Plan language changes, or to correct Plan operation errors at little or no cost.

3. *Favorable Application for Determination Upon Plan Termination* – Filing a favorable determination request with the IRS at Plan termination is not legally required. The IRS can take between 12 and 24 months to respond. If the Plan was recently amended to conform to Tax Code changes, the likelihood of plan qualification forum problems is remote. Under these circumstances, it may be prudent not to pursue this costly and time consuming procedure.

4. *Notice to Plan Participants of Plan Termination* – Plan participants must be sent via certified mail a notice of plan termination indicating their rights to receive a lump sum distribution from the Plan. This notice will indicate the termination date and shall disclose to each participant his or her account balance. The Participants will also be informed of their right to take a tax-free rollover of their retirement plan monies.

5. *Final Plan Contributions* – If there are any missing employee or employer contributions, steps must be taken to make sure that these contributions are made prior to Plan termination.

6. *Allocating Forfeitures* – Prior to sending out the Notice of Termination, any forfeitures should be reallocated in accordance with the plan's terms. Usually the plan states forfeitures are to be reallocated on a pro rata basis to participant accounts.

7. *Missing Participants* – The Plan sponsor or the person acting on the Plan sponsor's behalf, must make efforts to locate missing participants. The Department of Labor in Field Assistance Bulletin 2004-02, recommends using certified mail to contact participants in connection with Plan distributions. In the event certified mail to a participant is returned, the Government recommends checking the business records of the employer for a more current mailing address. Finally, the DOL recommends using either the IRS or the Social Security Administration's letter forwarding services in connection with missing participants. To use either the IRS or FSA program, the requestor must submit a written request for letter forwarding to the agency and must provide the missing participant's social security number or other identifying information. In the event a missing participant cannot be located, the Plan's fiduciary may consider distributing a missing participant's benefits into individual retirement accounts. The Plan fiduciary may also consider establishing an interest-bearing federally insured bank account in the name of the missing participant as long as the

participant has the unconditional right to withdraw funds from the account. As an alternative, Plan fiduciaries may also consider transferring missing participant account balances to state unclaimed property funds in the state of each participant's last known residence or work location.

8. *Plan Distributions* – At the time participants are sent via certified mail the Notice of Plan Termination, they must also receive a Plan Distribution Form, as well as a Tax Notice explaining the income tax treatment of their Plan distribution.

9. *Complete Plan Distributions Within 12 Months* – The IRS indicates that 12 months is the maximum amount of time it will consider as reasonable for distributing a Plan's assets at termination.

10. *Continue to File Form 5500s* – Until all Plan assets are distributed, Form 5500s must continue to be filed. A final Form 5500 is due seven (7) months following the date of the final Plan distribution.

Part II of this article in the next issue of RN will discuss the new streamlined "abandoned plan" rule.

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San Francisco office whose practice focuses on ERISA litigation and the counseling of employers on the entire spectrum of employee benefit and executive compensation matters. Chambers USA 2010 describes Mr. Baker as "an ERISA legend on the West Coast," and the National Law Journal has recognized Mr. Baker as one of the forty best employee benefit attorneys in the U.S. He has been chosen as the best ERISA litigator in San Francisco by "Best Lawyers in America" for 2012. The views set forth herein are the personal views of Mr. Baker and do not necessarily reflect those of the law firm with which he is associated. Note from Chapter 11 Trustee McFarland:
Mr. Baker has performed extraordinary services for this Chapter 11 Trustee on a very complex plan that required termination as soon as possible for the benefit of all participants and the bankruptcy estates where the participants were employed.

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