

# CLIENT UPDATE

## UPPING THE ANTE: PBGC INITIATES PENSION PLAN TERMINATION IN LEVERAGED ACQUISITION

### NEW YORK

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Buyers and sellers in typical leveraged buyouts of subsidiaries and divisions have long recognized that the Pension Benefit Guaranty Corporation (“PBGC”) could perceive its own interests as threatened in the transaction and, consequently, might choose to interfere with the parties’ bargain. This concern has to date been viewed as largely theoretical, as the PBGC typically either does not appear in a transaction at all, or, if it does appear, extracts relatively modest protections from the parties. Two recent developments suggest that the PBGC intends to become more active in buyout transactions:

- In April, the PBGC initiated proceedings to terminate a pension plan in connection with Compagnie de Saint-Gobain’s sale of its US metal and glass containers business to Ardagh Group. Initiation of a plan termination is typically viewed as an attempt to scuttle a transaction.
- In a recent interview, a senior PBGC official announced that the PBGC intends to become more aggressive in scrutinizing future buyout transactions and to allocate more of its resources in this area.

### *Background*

As the federal guarantor of corporate pension plans, the PBGC has a potential economic interest in any transaction in which (1) debt is layered onto a business, especially secured debt, and/or (2) a smaller asset base is available to support future plan contributions. Both of these factors are present in a typical leveraged buyout of a division or subsidiary.

Because of an unusual and limited statutory framework, the PBGC's principal means of protecting its insurance fund in buyout transactions is the threat of terminating the plan. The Employee Retirement Income Security Act of 1974 ("ERISA") provides the PBGC with discretion to terminate a pension plan if, among other things, the loss to the PBGC is expected to increase unreasonably if the plan is not terminated. If a plan is involuntarily terminated in this manner before a transaction closes, the PBGC has a claim against the plan sponsor and all of its affiliates for the unfunded plan liabilities. As a result, if the PBGC is concerned that a proposed buyout of a business with an underfunded plan could result in a significant increase in the risk of loss to the PBGC, the PBGC could threaten to terminate the pension plan before the transaction closes, thus crystallizing its claim against both the seller and the business being sold. This threat makes it unlikely that the parties and the lenders will proceed, thereby potentially scuttling the transaction.

In practice, the PBGC generally has not sought to end a transaction, but rather to negotiate with the plan sponsor to obtain protections for the insurance fund as an alternative to terminating the plan. These alternatives could include promises of additional cash contributions to the plan, letters of credit to secure promises to make future contributions to the plan, pledges of security interests in certain assets, parent or affiliate guarantees or ongoing information requests.

Two points of this statutory scheme are worth emphasizing. First, the PBGC should never want to terminate a plan in connection with a buyout, or should want to do so only as a matter of last resort, because terminating the plan would require the PBGC to dip into its insurance fund, and this is the very event that the PBGC is intending to avoid. It is for this reason that threats of plan terminations have been perceived, in some cases, as overtures to negotiation and, in other cases, as empty bluffs. Second, the PBGC loses all of its leverage once the deal closes. This is so because, after a deal closes, the PBGC loses the ability to chase the assets of the seller and its affiliates and will typically only have a claim against the new standalone entity – and that claim is subordinated to any new secured debt.

*The PBGC's Recent Focus on Buyouts*

On April 18, 2013, the PBGC took the highly unusual step of filing a complaint in Pennsylvania court to involuntarily terminate a pension plan in connection with Compagnie de Saint-Gobain's sale of its US metal and glass containers business to Ardagh Group. The PBGC has said that it is concerned that Ardagh, a non-investment-grade buyer headquartered in Luxembourg that will finance the \$1.7 billion transaction with \$1.45 billion of debt, will end up in bankruptcy and leave the PBGC with a \$500 million unfunded liability. The PBGC also has said that it tried to negotiate with Saint-Gobain to obtain guarantees and additional contributions to the plan, but that Saint-Gobain has taken the position that it views its plan as very well funded. (These differing views likely exist because the PBGC values liabilities on a "wind-up" rather than "going-concern" basis, which has the effect of magnifying any underfunding.)

Separately, Sanford Rich, the new head of the PBGC's negotiations and restructuring group, gave a press interview in which he announced that the PBGC intends to take a more active role in buyout transactions. Mr. Rich is reported to have said that he believes the PBGC has been "insufficiently aggressive" and that private equity funds should "assume that [the PBGC] will be there" in future buyouts of divisions and subsidiaries.

The PBGC's complaint in the Saint-Gobain matter and Mr. Rich's public statements together amount to a significant increase in PBGC-related risk in buyout transactions – risk that buyers and sellers should not discount or ignore. While the outcome of the PBGC's renewed focus on buyout transactions remains to be seen, the agency may not be bluffing anymore. Further proceedings in the Saint-Gobain matter will be a crucial test, and should be closely followed.

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Please do not hesitate to contact us with any questions.

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