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Lost and Found: The Abandoned Plan Rule

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Do you remember your first trip to the "lost and found" department? Mine occurred in first grade. My mother had given me a copy of *The Ugly Duckling* storybook, complete with fuzzy feather illustrations and who knows what else. I "needed" the book for "show and tell" and was given specific instructions: "Do not lose this book!" Naturally, I lost the book. Upon my return home, bereft of cunning or wit, I told my mom the bad news. She was not happy. Suffice it to say she proceeded to show me the second use for the soles of her high-heeled shoes.

The next day, as a twosome, we returned to school, where she prodded me to ask my teacher whether anyone had turned *The Ugly Duckling* in to the "lost and found." Sadly, while my school's lost and

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found department (in the mean principal's office) had wardrobes full of misplaced shoes, sweaters, and hats, *The Ugly Duckling* was not to be found.

A far happier "lost and found" adventure visited ERISA practitioners in late May. Some five years ago, the US 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 provide a streamlined process for winding up the affairs of abandoned individual account retirement plans (which include 401(k) plans).[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 without a plan sponsor and or 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, by fiat the DOL precluded bankruptcy trustees from using the "abandoned plan" rule. Then, on May 26, 2011, the DOL reversed course by announcing it would expand the "abandoned plan" rule to include liquidating bankruptcy trustees. It reasoned that using the abandoned plan rule in bankruptcy liquidations had the potential to substantially reduce burdens on abandoned plans, their participants and bankruptcy trustees.

Bankruptcy's Catch-22

For the past five years, the DOL has harassed and harried any bankruptcy trustee who attempted to use the abandoned plan rule.[2] Commendably, the DOL's announcement returns the abandoned plan rule to 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 "Catch-22" situation. Some bankruptcy courts held that administration of a debtor's 401(k) plan falls outside the bankruptcy court's jurisdiction,[3] while others ruled a bankruptcy trustee's 401(k) plan administration was subject to bankruptcy court jurisdiction.[4] To be fair, Bankruptcy Code Section 704(a)(11) is 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;** [emphasis supplied.]

In the cases cited above, the DOL maintained that a bankruptcy trustee was the plan administrator by operation of 11 U.S.C. Section 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 Section 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 DOL had consistently maintained that Chapter 11 bankruptcy trustees were ERISA plan administrators by operation of 11 U.S.C. Section 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. Section 704(a)(11)—but it did not. Instead, Section 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. According to this statutory language, a bankruptcy trustee is, at most, a limited purpose ERISA fiduciary.

The Regulatory Solution

In its May 2011 "Preliminary Plan for Retrospective Analysis of Existing Rules," the DOL stated:

> [B]ankruptcy trustees, who often are unfamiliar with applicable fiduciary requirements and plan-termination procedures, presently have little in the way of a blueprint or guide for efficiently terminating and winding up such plans. Expanding the program to cover these plans will allow the responsible bankruptcy trustees to use the streamlined termination process to better discharge its obligations under the law. The use of streamlined procedures will reduce the amount of time and effort it ordinarily would take to terminate and wind up such plans. The expansion also

> will eliminate government filings ordinarily required of terminating plans. Participation in the program will reduce the overall cost of terminating and winding up such plans, which will result in larger benefit distributions to participants and beneficiaries in such plans.

The allure of the "abandoned plan" rule for bankruptcy trustees comes from the depressing experience of using the standard retirement plan termination process. The traditional procedures for terminating and winding up ERISA-regulated 401(k) plans can be time-consuming, complicated, and tedious. Under the standard retirement plan termination procedures the 401(k) plan must be updated to conform to the current Tax Code requirements, missing or incomplete Annual Form 5500 Reports must be corrected (and if necessary, late filing penalties paid), operational defects must be corrected through EPCRS, etc.

The DOL's "Termination of Abandoned Individual Account Plans" regulation (which encompasses 401(k) plans, money purchase pension plans, profit sharing plans, and ESOPs) shortcuts these standard termination procedures in favor of its own streamlined process.[5] The Abandoned Plan Regulation provides standards for determining when a plan is abandoned, simplifies the procedures for winding up a plan, limits the exposure of the "qualified termination administrator" (QTA) to ERISA fiduciary breach claims, and sets forth a simplified process for distributing the plan's assets to participants. What follows is a short summary of how the abandoned plan process will work in a bankruptcy liquidation.

Identifying the Qualified Termination Administrator

The first step in this process is to identify the "qualified termination administrator." A QTA is responsible for determining whether an individual account plan is abandoned and for carrying out the activities associated with terminating and winding up the plan's affairs. Pursuant to 29 C.F.R. Section 2578.1(g), the QTA must meet two requirements. First, the QTA must be "eligible to serve as a trustee or issuer of an individual retirement plan, within the meaning of section 7701(a)(37) of the Internal Revenue Code."[6] Second, the QTA must be holding assets of the abandoned plan.[7] A liquidating bankruptcy trustee easily meets both of these requirements.

Eligible Plans

To qualify as an abandoned plan and be eligible for termination under the procedures set forth in the Abandoned Plan Regulation, a QTA must make two findings. First, the QTA must find that either no

contributions to, or distributions from the plan have been made for at least 12 consecutive months immediately preceding the date on which the determination is being made; or other facts and circumstances, including the filing by or against the plan sponsor for liquidation under Title 11 of the United States Bankruptcy Code, including any other actions that suggest to the QTA or which the QTA is aware of that the plan is or may become abandoned by the plan sponsor.[8] Second, if, after reasonable efforts to locate or communicate with the plan sponsor, the QTA determines that the sponsor no longer exists, cannot be located, or is unable to maintain the plan, then the plan can be found abandoned.[9] Once found abandoned, a plan is officially "deemed terminated" 90 days following the date a letter is received from the EBSA's Office of Enforcement acknowledging receipt of the notice of plan abandonment.[10]

Streamlined Process for Winding up the Affairs of Individual Account Plans

The steps to wind up an abandoned 401(k) plan are simple and straightforward. The QTA must update the plan's records; calculate the benefits payable to each participant or beneficiary; report delinquent contributions; engage service providers; pay (from plan assets) all reasonable expenses associated with carrying out the QTA's tasks; provide written notice to all plan participants or beneficiaries; distribute the benefits; file a Special Terminal Report for Abandoned Plans;[11] and circulate a final notice.[12]

Limited ERISA Liability

A QTA is deemed by this regulation to have satisfied the fiduciary requirements of ERISA Section 404(a) with respect to winding up the plan, except for selecting and monitoring service providers used in terminating the plan.[13] This streamlined process for abandoned 401(k) plans does *not* require abandoned plans to be requalified under the Tax Code nor does it require the QTA to file any Form 5500s. The QTA is also not required to conduct an inquiry to determine whether breaches of fiduciary responsibility may have occurred with respect to a plan prior to becoming the plan's QTA.[14] The QTA is not obliged to collect delinquent contributions on behalf of the plan as long as the QTA informs the DOL in writing about any known delinquencies.

Form 5500 Annual Reporting Relief

The QTA is not responsible for filing a Form 5500 annual report on behalf of an abandoned plan, either in the terminating year or

any previous plan years; but the QTA must complete and file a summary terminal report with the DOL at the end of the winding-up process.

Class Exemption

Accompanying the regulations is a class exemption that provides conditional relief from ERISA's prohibited transaction restrictions.[15] This exemption allows the QTA: to pay itself for services rendered to the plan prior to becoming the QTA; to provide services in connection with terminating and winding up the abandoned plan; and to make distributions from abandoned plans to IRAs or other accounts established by the QTA as a result of a participant's failure to tell the QTA where to send the participant's plan money. The QTA may also pay reasonable expenses for winding up the plan from the plan's assets.

Participant Notification

The QTA must notify participants that the plan is being terminated because it has been abandoned by the plan's sponsor. This notice must also inform the participant of his or her account balance and the date on which it was calculated. The participant notification must include the following statement, "The actual amount of your distribution may be more or less than the amount stated in this letter depending on the investment gains or losses and the administrative cost of terminating your plan and distributing your benefits."[16] Participants must also be informed of their distribution options. The distribution notice must include a statement explaining that if a participant fails to make a distribution election within 30 days from receipt of the notice, then the QTA will distribute the account balance to an IRA or to an interest bearing federally insured bank account or to the unclaimed property fund of the state of the last known address of the participant.

Procedure for Terminating an Abandoned 401(k) Plan

The regulations require that a "Notice of Intent to Terminate the Plan" must be sent to the former plan sponsor at his or her last known mailing address. This notice must be sent by certified mail. Thirty days after the day this notice is sent, a second notice of plan abandonment needs to be mailed. This notice goes to the DOL and must indicate the intent to serve as a QTA. A model notice has been posted on the DOL's Web site. A "notice of plan termination" then needs to be sent to the plan's participants after the 90-day notice

period provided to the DOL has expired. Participants have 30 days to inform the QTA how they wish to receive their plan distributions. A model participant Notice of Plan Termination is also provided by the government. When all of the plan's assets have been distributed, a "Final Notice" must be sent to notify the DOL that the termination process has been completed. A model "Final Notice" is also provided by the government.

No Need to Update the Plan

The IRS stated in the "Abandoned Plan" Regulation that it will not challenge the qualified status of any plan terminated under this regulation or take any adverse action against, or seek to assess or impose any penalty on, the QTA, the plan, or any participant or beneficiary of the plan as a result of the termination, including the distribution of the plan's assets, provided the QTA satisfies three conditions. First, the QTA reasonably determines whether the survivor annuity requirements of the Tax Code apply to any benefit payable under the plan. The qualified joint and survivor annuity provisions of the Tax Code do not apply to ESOPs. Second, each participant must be provided with a non-forfeitable right to his or her accrued benefits as of the date of the termination, subject to income, expenses, gains and losses between the date of the Termination Notice and the date of distribution. Third, participants and beneficiaries must receive a notice of their right to roll over amounts from the 401(k) plan to an IRA. An IRS model notice concerning rollovers is also available.

Conclusion

For 401(k) plan participants whose plan sponsor is in bankruptcy liquidations, following the standard retirement plan termination procedures must feel like one last kick in the teeth. After experiencing bounced payroll checks and worse, these former employees are then faced with the double whammy of a prolonged 401(k) plan termination and the burden of significant expenses incurred during the termination process charged to their individual plan accounts. The "abandoned plan" rule should be a significant help to liquidating bankruptcy trustees. It will simplify defined contribution retirement plan terminations, it will lower plan expenses, and it will insulate the bankruptcy trustee from ERISA claims during the plan termination process. More importantly, these new rules will speed up the termination of the retirement plan as well as the distribution of the retirement plan's assets to the plan's participants. Sometimes what is lost is found.

Notes

1. 29 C.F.R. § 2578.1.

2. *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.

3. Mid-States, *supra.*

4. *In re The Robert Plan Corp.,* 439 B.R. 29, 42 (Bankr. E.D.N.Y. 2010).

5. *See* 29 C.F.R. § 2578.1 (Abandoned Plan Regulation).

6. 9 C.F.R. § 2578.1(g)(1).

7. *Id.* at § 2578.1(g)(2).

8. 29 C.F.R. §§ 2578.1(1)(i)(A), (B).

9. *Id.* at §§ 2578.1(b)(ii)(A)–(C).

10 29 C.F.R. § 2578.1(c); A copy of the "abandoned plan" regulation can be downloaded from the following Web site: *http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr&tpl=/ecfrbrowse/Title29/29cfr2578_main_02.tpl.* The regulation includes an Appendix containing all relevant model letters and notices.

11. *See* 29 C.F.R. §§ 2520.103–113.

12. 29 C.F.R. § 2578.1(d).

13. 29 C.F.R. § 2578.1(e).

14. 11 29 C.F.R. § 2578.1(e)(2).

15. 12 PTE 2006-06.

16. 29 C.F.R. § 2578.1(d)(2)(vi)(3)(ii).

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