No. 14-5573

In the

United States Court of Appeals

for the Sixth Circuit

PENSION BENEFIT GUARANTY CORPORATION,

Plaintiff-Appellee,

v.

KENTUCKY BANCSHARES, INC.,

Defendant-Appellant.

On Appeal from the United States District Court
For the Eastern District of Kentucky at Lexington

BRIEF OF PLAINTIFF-APPELLEE

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DISCLOSURE OF CORPORATE AFFILIATIONS AND FINANCIAL INTERESTS

Appellee Pension Benefit Guaranty Corporation ("PBGC") is an agency of the United States government. Thus, disclosure of Corporate Affiliations and Financial Interests is not required under Sixth Circuit Rule 26.1.

/s/ Sara B. Eagle
Sara B. Eagle

September 4, 2014

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STATEMENT REGARDING ORAL ARGUMENT

PBGC does not believe oral argument is warranted in this case, because the facts and legal arguments are adequately presented in the briefs and record, and the decisional process would not be significantly aided by oral argument.

STATEMENT OF THE ISSUE PRESENTED FOR REVIEW

Did the District Court err in upholding PBGC's final determination that the amendment to the Kentucky Bancshares, Inc. Retirement Plan and Trust (the "Plan") violated PBGC regulation 29 C.F.R. § 4041.8 because it reduced participants' benefits after its termination date, and was not necessary to maintain the Plan's tax qualification?

INTRODUCTION

Before Congress passed the Pension Protection Act of 2006 ("PPA"),[1] few pension plans allowed participants to elect to receive their benefits in a lump sum, because the actuarial assumptions required to calculate a lump sum amount favored participants, not plans.[2] When converting the present value of a plan participant's accrued benefit to a lump sum, the plan was allowed to assume that the lump sum would, at a minimum, earn the conservative interest rate paid on 30-year United States Treasury bonds.[3] Under the PPA, however, that calculation could be

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[1] Pub. L. 109-280, 120 Stat. 780 (2006).

[2] *See* Prudential, *Retirement Plan Strategies, De-Risking Pensions – Emerging Opportunity Through Lump Sum Cash-Outs Under the Pension Protection Act of 2006* (hereinafter "Retirement Plan Strategies"), at 1, *available at* http://news.prudential.com/images/20026/WhitePaper.pdf (last visited September 3, 2014).

[3] *See* Retirement Protection Act of 1994 (within the Uruguay Round Agreements Act) Pub. L. 103-465, § 767, 108 Stat. 4809, 5039-40 (1994) ("GATT").

performed, for plan years after December 31, 2007, assuming participants would, at a minimum, earn the average yields of corporate bonds.[4]

The lump sum benefit amount determined using corporate bond assumptions is almost always smaller than the benefit calculated using 30-year Treasury rates. This is because the higher the interest rate a participant is presumed to earn on a lump sum, the lower the amount of the lump sum required to be paid. This is true of present value computations generally.[5]

The new PPA interest rates, combined with the fact that paying lump sums is typically cheaper than purchasing annuity contracts from an insurance company,[6] significantly lowered the cost of lump sums for plans. Accordingly, plan sponsors who amended their plans to include lump sums were able to: 1) transfer risk (at low cost) to retirees who elected payment of lump sums in lieu of a fixed stream of income from the plan; and 2) in the case of terminating plans, more cheaply fund

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[4] PPA, Pub. L. 109-280, § 302(b); 26 U.S.C. § 417(e)(3).

[5] *See Rybarczyk v. TRW, Inc.*, 235 F.3d 975, 978 (6th Cir. 2000); *Powell Valley Nat'l Bank v. PBGC*, No. 2:12CV00018, 2013 WL 4759242, at *4 n.9 (W.D.VA. Sept. 4, 2013) (citing *Jones & Laughlin Steel Corp. v. Pfeifer*, 462 U.S. 523, 537 n.21 (1983).

[6] *See, e.g.*, Investopedia, *Passing the Buck: The Hidden Costs of Annuities*, http://www.investopedia.com/articles/retirement/02/031302.asp, last visited September 3, 2014.

standard terminations, in which plan sponsors must pay all benefit liabilities due under the plan.[7]

In September 2008, after PPA was enacted, and just before terminating its Plan, Kentucky Bancshares amended the Plan to provide lump sums as an optional form of benefit payment. (*See* Request for reconsideration, Appellant's App., p. 78). But Kentucky Bancshares did not adopt an amendment specifying use of PPA minimum assumptions (the "PPA Assumptions") for calculating lump sums (the "PPA Amendment") until after its chosen Plan termination date. (*See* DB Termination Amendment, Appellant's App., p. 64).[8] This course of action reduced benefits after Plan termination in violation of PBGC regulation 29 C.F.R. §4041.8.

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[7] *See Retirement Plan Strategies* at 4. Kentucky Bancshares appears to cite the Technical Explanation of H.R. 4 for the proposition that Congress adopted PPA with the intent of reducing lump sum benefits and making them less attractive to plan participants. (*See* Appellant's Br. at 6). But the cited pages merely explain the mechanics of the interest rate assumptions under the PPA. (*See* JCX-38-06, Technical Explanation of H.R. 4, The "Pension Protection Act of 2006," as Passed by the House on July 28, 2006, and as Considered by the Senate on August 3, 2006, pp. 73-76, *available at* http://www.dol.gov/ebsa/pdf/x-38-06.pdf, last visited September 3, 2014).

[8] A plan sponsor is generally free to create, modify, or terminate its pension plan at any time. *Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432, 443-44 (1999). Under Title IV, it is the employer who determines that the plan will be terminated, controls the execution of the plan amendments necessary for termination, and, through its chosen administrator, sets the plan termination date. *See Beck v. PACE Int'l Union*, 551 U.S. 96, 101-02 (2007); 29 U.S.C. §§ 1341(a)(2), 1348(a)(1).

STATUTORY AND REGULATORY BACKGROUND

I. Title IV and PBGC

Congress enacted the Employee Retirement Income Security Act of 1974 ("ERISA") to provide minimum standards that assure the equitable character and financial soundness of employee pension plans. 29 U.S.C. § 1001(c). Congress also declared it to be a policy of ERISA "to increase the likelihood that participants and beneficiaries under single-employer defined benefit pension plans will receive their full benefits." 29 U.S.C. § 1001b(c)(3). In Title IV of ERISA, Congress established PBGC as the government agency responsible for enforcing and administering the termination insurance program. 29 U.S.C § 1302. Title IV (with limited exceptions), covers pension plans that meet the qualification requirements under § 401 of the Internal Revenue Code ("I.R.C."). 29 U.S.C. § 1321(a) and (b).

Title IV provides the exclusive means of terminating a defined benefit pension plan. 29 U.S.C. § 1341(a)(1).[9] An employer may terminate a plan in a standard termination under Title IV only if the plan has sufficient assets to cover all benefit liabilities. 29 U.S.C. § 1341(b). In calculating and paying benefit liabilities in a standard termination, the plan administrator must comply with

[9] *See also Beck v. PACE Int'l Union*, 551 U.S. 96, 102-03 (2007); *Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432, 446 (1999).

ERISA and PBGC's regulations.[10] And after the plan administrator distributes the plan's assets, PBGC continues to have authority over matters relating to the plan, 29 U.S.C. § 1341(b)(4), and is required, under 29 U.S.C. § 1303(a), to audit a statistically significant number of standard terminations to determine, *inter alia*, whether affected parties have received the benefits to which they are entitled under the provisions of the plan (in effect on the date of plan termination) and any applicable regulations. *See* 29 U.S.C. §§ 1303(a), 1341(b)(1)(D), and 1341(b)(3)(A).

II. Standard Terminations

A. <u>The importance of termination dates</u>

In a standard termination, a final distribution of assets may only occur if plan assets are sufficient to pay all participants' benefit liabilities determined as of the plan's termination date. 29 U.S.C. § 1341(b)(1)(D). Accordingly, benefits must be determined under the plan provisions in effect on the plan's termination

[10] Standard termination "procedures are exhaustive, setting detailed rules" for all phases of the process. *See, e.g.*, *Beck*, 551 U.S. at 102. The plan administrator must provide each affected party with: 1) a notice of intent to terminate, which includes a proposed date of plan termination; and 2) a notice of plan benefits, explaining the benefits owed to each affected party. *See* 29 U.S.C. §§ 1341(a)(2), (b)(2)(B); 29 C.F.R. § 4041.23, 4041.24. The plan administrator must also file certain forms with PBGC. The Form 500 provides information about the plan sponsor's intent to terminate the plan, the proposed date of plan termination, and, *inter alia*, detailed information about plan assets and benefit liabilities. *See* 29 U.S.C. § 1341(b)(2)(A); 29 C.F.R. § 4041.25. The Form 501, filed after plan assets are distributed, attests that all benefits under the plan have been paid in accordance with Title IV. *See* 29 U.S.C. § 1341(b)(3)(B); 29 C.F.R. § 4041.29.

date. 29 C.F.R. § 4041.8. A plan's termination date is the date on which all benefit accruals cease, and as of which all benefits owed to plan participants are determined. *See* 29 U.S.C. § 1341(b)(1)(D) (requiring that plan liabilities be determined as of the plan's termination date).[11] Title IV's mandate that participants receive the benefits to which they are entitled as of a plan's termination date compels strict adherence to the statutory requirement that an exact plan termination date be set. *See* 29 U.S.C. §§ 1348 (addressing plan termination dates); 1341(a)(2) (requiring issuance of a notice of intent to terminate a pension plan with the proposed termination date); 29 C.F.R. §§ 4041.23(b)(2) (discussing the content of any notice of intent to terminate a plan); 4041.25 (discussing the standard termination notice that must be filed with PBGC).

ERISA also requires that defined benefit plans "be established and maintained pursuant to a written instrument," 29 U.S.C. § 1102(a)(1), and "specify the basis upon which payments are made . . . from the plan." 29 U.S.C. § 1102(b)(4). Thus, ERISA "has an elaborate scheme in place for enabling beneficiaries to learn their rights and obligations at any time [including on a plan's termination date], a scheme that is built around reliance on the face of written plan

[11] *See also PBGC v. Republic Techs. Int'l, LLC*, 386 F.3d 659, 662 (6th Cir. 2004) (citation omitted).

documents."[12] Accordingly, "[i]t would defeat congressional intent . . . if retroactive amendments after termination could alter substantive rights of [a] pension plan."[13]

To ensure that participants and beneficiaries receive the benefits they earned under the plan's provisions in effect on the plan's termination date, in 1997 PBGC promulgated 29 C.F.R. § 4041.8, 62 Fed. Reg. 60,424 (Nov. 7, 1997), formalizing its longstanding position that Title IV prohibits post-termination amendments that reduce benefits.[14] The regulation requires benefits to be determined using the plan provisions in effect on the plan's termination date, s*ee also* 29 U.S.C.

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[12] *Curtiss-Wright Corp. v. Schoonejongen*, 514 U.S. 73, 83 (1995) (emphasis omitted) (*citing* H.R. Rep. No. 93-1280, at 297 (1974). *See also Sprague v. Gen. Motors Corp.*, 133 F.3d 388, 402-03 (6th Cir. 1998) (stating that plans must be maintained in a written document to ensure participants are informed, citing *Schoonejongen*, and finding that lesser writings do not constitute plan amendments).

[13] *Audio Fid. Corp. v. PBGC*, 624 F.2d 513, 517 (4th Cir. 1980) (disallowing retroactive amendments after the date of plan termination). Kentucky Bancshares argues that it amended the Plan *de facto* to use PPA Assumptions before Plan termination based on a litany of communications with The Standard, the Plan's record keeper and actuary (*see* Appellant's Br. at 8-10), and its payment of PPA-valued lump sums to two participants just before the termination date (*see id.* at 10). (*See* Cross Motion for Summary Judgment at 19-23, RE 22, Page ID # 112-16). PBGC's final determination found that these actions were not sufficient to amend the Plan (*see* Reply to Motion for Summary Judgment at 11-16, RE 25, Page ID # 230-35), the District Court upheld that determination (*see* Opinion & Order at 14, RE 27, Page ID # 286), and Kentucky Bancshares did not seek to appeal this issue. (Appellant's Br. at 2-3).

[14] *See, generally, Audio Fid.*, *supra* at note 13.

§ 1341(b)(1)(D), and prohibits, except where required for tax qualification purposes, amendments adopted after the date of plan termination that reduce the value of benefits. 29 C.F.R. § 4041.8.

B. Form of distribution

The plan administrator must distribute the plan's assets in a standard termination by (a) purchasing "irrevocable commitments" (*i.e.*, annuities) from a private insurer to satisfy all benefit liabilities, 29 U.S.C. § 1341(b)(3)(A)(i); or (b) an alternative form of distribution (*e.g.*, lump sum payment) "in accordance with the provisions of the plan and any applicable regulations . . . ." 29 U.S.C. § 1341(b)(3)(A)(ii). To value a lump sum, the amount of a participant's monthly pension benefit must be calculated under the plan's terms. Then, that projected stream of future payments must be discounted to a present value, as of the date of distribution, 29 C.F.R. § 4041.28(c)(2), using assumptions for mortality and interest specified in the plan. *See* 26 U.S.C. § 401(a)(25). The interest rates used to discount to present value are inversely related to the amount of the lump sum (*i.e.*, the greater the interest rate, the lower the lump sum). Additionally, because of the power of compounding and the long-term nature of pension liabilities, a slight change in the interest rate can have a significant impact on the amount of a lump sum.[15]

[15] *See Powell Valley*, at *4 n.9.

III. The Internal Revenue Code

A. Section 417(e)

To be tax-qualified under § 401(a) of the I.R.C., a pension plan must, *inter alia*, meet the requirements of I.R.C. § 411. 26 U.S.C. § 401(a)(7). Section 411(a) establishes a floor for lump sum valuations, requiring that the present value of a lump sum benefit shall not be less than the present value calculated using the specified "applicable mortality table" and the "applicable interest rate" assumptions. *See* 26 U.S.C. §§ 411(a)(11)(B); 417(e)(3). These I.R.C.-specified assumptions have changed periodically since ERISA's enactment. Most recently, for plan years beginning after December 31, 2007, PPA § 302 amended the I.R.C. to change the "applicable interest rate" from the annual rate of interest on 30-year Treasury securities, GATT, Pub. L. 103-465, § 767, to the adjusted first, second, and third "segment" rates derived from a corporate bond yield curve. PPA, Pub. L. 109-280, § 302(b), 120 Stat 780, 920-21; 26 U.S.C. § 417(e)(3); *see also* 29 U.S.C. § 205(g). PPA also replaced the '94 Group Annuity Reserving ("GAR") Mortality Table, as the "applicable mortality table" used for lump sum calculations, with a mortality table specified under I.R.C. § 430(h)(3)(A). 26 U.S.C § 417(e)(3)(B); *see also* Rev. Rul. 2001-62, 2001-53 I.R.B. 632; Rev. Rul. 2007-67, 2007-48 I.R.B. 1047.

B. I.R.C. § 411(d)(6)

Section 411(d)(6) of the I.R.C. and Section 204(g) of ERISA, (29 U.S.C. § 1154(g)), prohibit plan amendments that reduce accrued benefits (the "anti-cutback rule"). Moreover, plan benefits paid in an optional form (including lump sums) must be the actuarial equivalent of the participant's annual benefit commencing at normal retirement age. 26 U.S.C. § 411(c).

IV. PPA § 1107 and PBGC's Regulation 4041.8

Under § 1107 of PPA, PPA amendments did not have to be adopted until the last day of the first plan year beginning on or after January 1, 2009, if the amendments complied with PPA, were timely made, were retroactive to the applicable PPA effective date, and the had been operated as if the amendments were in effect during the period beginning on the effective date of the applicable PPA provision addressed by the amendment and ending on the date the amendment was adopted. Recognizing that required PPA amendments might reduce accrued benefits under plans, in PPA § 1107, Congress also provided that if plans complied with the requirements listed above, they would not violate I.R.C. § 411(d)(6) or ERISA § 204(g). [16]

PPA § 1107 did not provide relief from Title IV of ERISA. PPA, Pub. L. 109-280, § 1107. Accordingly, while exempted from the I.R.C.'s and Title I's

[16] PPA, Pub. L. 109-280, § 1107.

anti-cutback provisions, post-termination PPA amendments that reduce benefits are still prohibited by PBGC regulation 4041.8. This was explained in PBGC's section of the IRS's Spring 2007 edition of its Employee Plan News publication:

> [PPA] provides for new assumptions for determining minimum lump sum amounts effective (with some phase-in) for distributions in plan years beginning after December 31, 2007. PPA substitutes a rate that reflects the yield on corporate bonds of various maturities for the 30-year Treasury bond rate and changes the mortality table used in determining minimum lump sum values under section 417(e)(3) of the Code. For qualification purposes, plans are not required to be amended until the end of the 2009 plan year, and they may be amended after the plan termination date if the plan has been submitted for a determination letter. However, **for purposes of Title IV of ERISA, plans terminating after the effective date of this PPA change must be amended before the date of plan termination in order to pay lower lump sum benefits under PPA assumptions**. PBGC's standard termination regulation limits the effectiveness of amendments adopted after a plan's termination date when determining plan benefits in a standard termination (29 CFR § 4041.8). Under this regulation, amendments adopted after the plan termination date generally may not be taken into account to the extent they decrease the value of plan benefits. **Although there is an exception if the decrease is necessary to meet qualification requirements, this exception would not apply to an amendment that simply substitutes new assumptions for old assumptions. The amendment can preserve the old assumptions as an alternative basis and still meet the qualification requirement.**

Employee Plan News, Vol. 7 (Spring 2007) at12, *available at* http://www.irs.gov/pub/irs-tege/spr07.pdf, last visited September 3, 2014 (emphasis added).

PBGC's explanation is in accord with IRS's guidance that a plan obtains PPA § 1107's qualification relief if it calculated lump sums as the greater of:

(i) the amount calculated by using the pre-PPA ’06 applicable mortality table and pre-PPA ’06 applicable interest rate, or
(ii) the amount calculated by using the post-PPA ’06 applicable mortality table and applicable interest.

IRS Notice 2008-30, 2008-12 I.R.B. 638, at Section IV. Thus, PPA § 1107 did not prohibit plans from paying larger lump sums than those provided by PPA’s new minimum assumptions under I.R.C. § 417(e).

STATEMENT OF THE CASE

I. The Plan’s Title IV Benefits

Kentucky Bancshares adopted the PPA Amendment after the date of Plan termination.[17] On the date the Plan terminated, it required lump sums to be calculated using 30-year Treasury rates and the ‘94 GAR mortality table (“GATT Assumptions”). (*See* Adoption Agreement for Invesmart, Inc., Appellee’s App., p. 117, ¶ 26 and Invesmart, Inc. Defined Benefit Prototype Plan and Trust, Appellee’s App., p. 140, § 1.4). (*See also*, Appellant’s Br. at 3). By valuing lump sums using the PPA Assumptions, rather than the GATT Assumptions specified in the Plan,

[17] The fact that Kentucky Bancshares received an IRS determination approving the PPA Amendment does not, as Kentucky Bancshares implies, have any bearing on whether the PPA Amendment violated Title IV. (*See* Appellant’s Br. at 12; IRS Determination Letter, Appellant’s App., pp. 25-26). As Kentucky Bancshares notes, IRS determination letters are not determinations regarding the effect of other federal statutes. (*See id.*) And, they are based on the information provided; and, thus, do not speak to other possible amendments that may have been sufficient for qualification. (*See id.*)

Kentucky Bancshares paid participants $1.3 million less in lump sum benefits. (*See* Cross Motion for Summary Judgment at 5-6, RE 22, Page ID # 98-99).

Under Title IV of ERISA, when an employer terminates a defined benefit pension plan in a standard termination, participants must receive the benefits to which they are entitled under the plan's provisions in effect *as of the date of plan termination,* and PBGC regulation 4041.8 prohibits post-termination amendments that reduce benefits unless those amendments are necessary for qualification under I.R.C. § 401. *See* 29 U.S.C. § 1341(b)(1)(D) and 29 C.F.R. § 4041.8. *See also* 26 U.S.C. § 401.

PPA § 1107 did not provide relief from PBGC's regulation barring post-termination amendments that reduce benefit amounts. Congress did not include such relief even though PBGC previously disallowed post-termination GATT amendments that reduced benefits, finding them unnecessary for plan qualification regardless of GATT's anti-cut back relief.[18] This course of Congressional action is

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[18] PBGC's position on this issue was well known. *See, e.g.,* Employee Plans News, Vol. 7 (Spring 2007) at 12 *available at* http://www.irs.gov/ pub/irs-tege/spr07.pdf.; Thomas J. Finnegan & James E. Holland, Jr., *PPA Update on DB Plans* (Presented at the 2008 Northeast Benefits Conference, noting, in Slide 53, that "PBGC said that plan must honor the plan provisions in effect on the plan termination date"), Attachment 1 (previously available at www.asppa.org); PBGC's Standard Termination filing instructions at 14-15, *available at* http://www.pbgc.gov/documents/500_ instructions.pdf; Harold J. Ashner, *PBGC Issues: Planning a Standard Termination—A Checklist for Practitioners*, 16 J. PENSION BENEFITS 67, 69-70 (Winter 2009) (discussing PBGC's interpretation of 29 C.F.R. § 4041.8 and recommending that amendments be adopted "on or

consistent with Title IV's requirement that payment of all benefit liabilities be determined on the date of plan termination. 29 U.S.C. § 1341(b)(1)(D).

II. The Plan Termination and Audit

On April 10, 2009, having adopted the PPA Amendment after the date of Plan termination, Kentucky Bancshares submitted a Form 500 - Standard Termination Notice for the Plan to PBGC, indicating a proposed termination date of December 31, 2008. (*See* PBGC Form 500, Schedule EA-S, Schedule REP-S, Appellant's App., pp. 17-21). PBGC then had 60 days to determine whether it had any reason to believe the Plan might not be sufficient for benefit liabilities (the "60-Day Review Period"). This review is limited, relying on documentation from the plan administrator, the plan's actuary or other affected parties, including an attestation that the plan is sufficient for benefit liabilities. 29 U.S.C. § 1341(b)(2)(A) and (C).[19] If PBGC does not issue a notice of noncompliance

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before the plan's proposed termination date"); David A. Pratt, *Focus on Interest Rates for Terminating Defined Benefit Plans*, 15 J. PENSION BENEFITS 5, 6 (Spring 2008) (discussing PBGC's interpretation of 29 C.F.R. § 4041.8); and Harold J. Ashner, *PPA Lump Sum Amendments in Standard Terminations: Watch Out!*, ASSPA Gov't Affairs Comm. Publ. 06-38 (Nov. 1, 2006) *available at* http://www.keightleyashner.com/ publications/ASPPA_111606.pdf (stating that "[i]f you intend to use the PPA assumptions (subject to the transition rule) to determine lump sum values for post-2007 distributions as part of a standard termination, you will need to ensure that the PPA lump sum amendment is adopted on or before the plan's termination date").

[19] Congress enacted Title IV's current standard termination procedures in the Single-Employer Pension Plan Amendments Act of 1986 ("SEPPAA"), which,

during the 60-Day Review Period (it did not in this case), Plan assets must distributed. 29 U.S.C. § 1341(b)(2)(D) and (b)(3); 29 C.F.R. § 4041.28.

On or about November 2, 2009, the Plan Administrator filed PBGC Form 501 - Post Distribution Certification for Standard Termination ("Form 501") with PBGC, certifying, *inter alia*, that all benefits payable under the Plan were calculated correctly in accordance with ERISA's provisions and regulations, and that all benefit liabilities under the Plan were satisfied. (*See* PBGC Form 501, Appellant's App., p. 23).

By letter dated January 21, 2010, PBGC notified Kentucky Bancshares that the Plan's termination had been selected for audit. (*See* Standard Termination Audit Letter, Appellant's App., p. 24).[20] The Administrator submitted a revised

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inter alia, streamlined procedures for determining whether a plan had sufficient assets to complete a standard termination, shifting the bulk of responsibility for that procedure to plan administrators and professionals. This change eased PBGC's administrative burden, as well as plan sponsors' filing requirements. Before SEPPAA, PBGC essentially conducted a plan termination audit before the distribution of plan assets. The agency had 90 days to determine – after the submission of, among other things, plan documents, participant notices, detailed information about the plan's assets and liabilities, and a proposed asset allocation – whether the plan assets were sufficient to pay all benefit liabilities in accordance with Title IV. *See* 29 U.S.C. § 1341(a) (as amended through 1984); 48 Fed. Reg. 3725, 3726-27 (Jan. 27, 1983)(codified at 29 C.F.R. pt. 2616.5); Form 5310, and Instruction, revised April, 1979.

[20] Throughout the termination process, PBGC reminds filers, as it did in this case, that PBGC may audit a plan after distributions are made. Upon receiving a Form 500, PBGC sends, as it did in this case, an acknowledgment of receipt to the filer, stating that assets may be distributed if PBGC does not issue a Notice of

Form 501 on or about February 26, 2010, amending the value of benefits distributed. (*See* Revised Form 501, Appellee's App., p. 106). In November 2010, Kentucky Bancshares submitted the sample participant data PBGC had requested in March 2010 to complete its audit. (*See* Emails enclosing sample participant data, Appellee's App., pp. 131, 132-33, 134). PBGC then received a copy of the PPA Amendment on January 25, 2011 (*see* Email enclosing PPA Amendments, Appellee's App., p. 210), and a copy of the documents regarding the group annuity contract in March 2011 (*see* Group Annuity Benefit Report, Appellee's App., pp. 211-41).

On April 8, 2011, PBGC issued an initial determination with respect to its audit, finding, *inter alia*, that Kentucky Bancshares had undervalued participants' lump sums and must therefore distribute additional assets to participants to comply with Plan provisions and applicable laws. (*See* Letter enclosing audit findings and

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Noncompliance within the 60-Day Review Period. (*See* Letter acknowledging receipt of standard termination notice, Appellant's App., p. 22). That acknowledgement directs the plan sponsor to PBGC's termination instructions requiring the sponsor to retain plan records for six years, as PBGC may audit its termination. *See* PBGC's Standard Termination Filing Instruction, at 16, *available at* http://www.pbgc.gov/ documents/500_instructions.pdf. After receiving a Form 501, PBGC again reminds plan sponsors and administrators of its audit program, sending (as in this case) an acknowledgment of receipt, stating, *inter alia.,* "[y]our plan may be selected for audit," "you will know within about four months whether we have selected your plan for audit," and providing a list of documents that may be requested upon audit. (*See* Letter acknowledging receipt of 501, Appellee's App. at 105.)

Summary of Audit Results, Appellant's App., pp. 68-71). Specifically, as it pertains to this appeal, PBGC found that the PPA Amendment adopted after the date of Plan termination decreased benefits in violation of 29 C.F.R. § 4041.8, because the amendment was not necessary to meet qualification requirements under I.R.C. § 401. (*Id.*) On June 6, 2011, Kentucky Bancshares requested reconsideration of the initial determination (*see* Request for reconsideration, Appellant's App., pp. 72-79); and, on May 9, 2012, PBGC issued its final determination, upholding the initial determination, (*see* Letter responding to Request for reconsideration, Appellant's App., pp. 101-04). The final determination upheld PBGC's initial determination that the PPA Amendment was adopted after the date of Plan termination, decreased benefits for participants and beneficiaries who elected lump sums, and was unnecessary to meet I.R.C.'s tax qualification requirements, thereby violating 29 C.F.R. § 4041.8. (*Id.*) The District Court upheld PBGC's final determination. (*See* Opinion & Order at 15-17, RE 27, Page ID # 287-89).

III. The Appeal

The sole issue on appeal is whether the PPA Amendment, made after the date of plan termination, violated PBGC regulation 4041.8 (*See* Appellant's Br. at 2-3). Kentucky Bancshares acknowledges that maintaining plan qualification when adopting PPA amendments did not require the wholesale replacement of

GATT Assumptions with PPA Assumptions, and that IRS allowed amendments that paid more than PPA minimum lump sums. (*See id.* at 7 n.6).[21]

But, Kentucky Bancshares argues that unlike other sponsors of terminating plans that failed to adopt their PPA amendments before the date of plan termination, it should not be treated as violating § 4041.8 because it used PPA Assumptions to calculate and pay lump sums to two participants before the date of Plan termination. (*See* Appellant's Br. at 14, 27-28).

According to Kentucky Bancshares, because it paid two participants' lump sum benefits calculated using PPA Assumptions before the date of Plan termination, it was constrained to adopt an amendment replacing the Plan's GATT Assumptions with the new PPA minimum lump sum assumptions, because that was the only amendment that was consistent with the way Kentucky Bancshares had operated the Plan before the amendment was adopted. (*See* Appellant's Br. at 27-28). As PBGC concluded, and the District Court agreed, however, while Kentucky Bancshares was required to amend the Plan to ensure that lump sums paid by the Plan had present values that were not less than lump sums calculated using PPA Assumptions, the PPA Amendment was not the only permissible amendment the Plan could have adopted to maintain tax qualification in

[21] *See, also generally*, *Powell Valley*, 2013 WL 4759242*; PBGC v. Town & Country Bank and Trust*, No. 3:11-CV-602-H, 2012 WL 4753352 (W.D. Ky. October 4, 2012) (both granting summary judgment to PBGC and invalidating post-termination PPA amendments that reduced benefits).

conformance with Plan operations. (*See* Opinion & Order at 16, RE 27, Page ID # 288).

SUMMARY OF ARGUMENT

The Administrative Record fully supports PBGC's finding that the PPA Amendment was not permitted under 29 C.F.R. § 4041.8, because Kentucky Bancshares could have made an alternate plan amendment without jeopardizing the Plan's tax qualification and without reducing benefits to Plan participants by $1.3 million. PBGC's interpretation of 29 C.F.R. § 4041.8 was not arbitrary or capricious and was consistent with applicable law. *See* 29 U.S.C. § 1341(b)(2)(D); 26 C.F.R § 4041.8; PPA, Pub. L. 109-280, § 1107; and IRS Notice 2008-30, 2008-12 I.R.B. 638, at Section IV.

ARGUMENT

I. Standard of Review

The District Court's decision on summary judgment upholding PBGC's final determination of its ERISA Title IV statutorily mandated audit of the Plan's standard termination is to be reviewed *de novo.*[22] Under the Administrative Procedure Act, an agency determination is to be upheld unless it is arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.

[22] *Davidson v. U.S. Dept. of Energy*, 838 F.2d 850 (6th Cir. 1988).

5 U.S.C. § 706(2)(A).[23] The scope of review under this standard is "narrow and the court is not to substitute its judgment for that of the agency."[24] And, the agency must simply articulate a "rational connection between the facts found and the choice made."[25]

Similarly, when an agency's interpretation of its governing statute is at issue, and Congress has not spoken directly to the matter, a court will defer to the agency's construction unless it is "arbitrary, capricious, or manifestly contrary to the statute."[26] Under this standard, the agency's interpretation need only be reasonable, not necessarily the best.[27] The court will apply even greater deference to an agency's interpretation of its own regulation, which "must be given 'controlling weight unless it is plainly erroneous or inconsistent with the regulation.'"[28] This deference applies where "the agency has been given

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[23] *See also Ohio Pub. Interest Research Grp., Inc. v. Whitman*, 386 F.3d 792, 795 (6th Cir. 2004).

[24] *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto Ins. Co.*, 463 U.S. 29, 43 (1983).

[25] *Id.* (*citation omitted*).

[26] *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 844 (1984).

[27] *Painting Co. v. N.L.R.B.*, 298 F.3d 492, 499-500 (6th Cir. 2002).

[28] *Thomas Jefferson Univ. v. Shalala*, 512 U.S. 504, 512 (1994); *accord Decker v. Nw. Envtl. Def. Ctr.*, 133 S. Ct. 1326, 1337 (2013).

responsibility to issue regulations under the statute in question, to explain responsibilities of those concerned under the statute, and to enforce the statute in court."[29]

Congress delegated authority over the termination insurance program to PBGC. *See* 29 U.S.C. § 1302.[30] In this case, in its role as administrator of Title IV of ERISA, PBGC interpreted Title IV and PBGC's own regulations in determining that Kentucky Bancshares did not fully comply with Title IV's requirements for completing a standard termination of a defined benefit pension plan.[31] To perform this statutorily mandated audit, PBGC must apply ERISA provisions beyond those in Title IV of the statute.[32] PBGC must frequently do that in carrying out its

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[29] *United States v. Cinemark USA, Inc.*, 348 F.3d 569, 578 (6th Cir. 2003); *See Bragdon v. Abbott*, 524 U.S. 624, 646 (1998).

[30] *See, also, Nat'l Fuel Gas Supply Corp. v. FERC*, 811 F.2d 1563, 1570 (D.C. Cir. 1987) (stating such a " grant of power embodies congressional recognition of the agency's 'special competence' to handle those matters, and compels deference from the courts in reviewing how that power is exercised").

[31] PBGC's role in this instance bears no resemblance to the role of the Director of the Office of Workers' Compensation Programs in *Metropolitan Stevedore Co. v. Rambo*, 521 U.S. 121, 137 n. 9 (1997), cited by Appellant, who the Supreme Court noted would not receive deference in his interpretation of the APA itself, which he obviously does not administer. (Appellant's Br. at 17).

[32] In addition to Title IV, ERISA includes: Title I (setting forth the reporting and disclosure, participation and vesting, funding, and fiduciary obligation provisions, pertaining to ongoing pension plan), 29 U.S.C. §§ 1001-1194; Title II (relating to the qualification of pension plans for favorable tax treatment (*see, generally* 26

responsibilities under Title IV.[33] PBGC has been given broad deference in interpreting the statute and its regulations, including certain regulations under Title II.[34]

U.S.C. §§ 401-424), and including the definition of the "benefit liabilities" that must be paid to complete a standard termination (s*ee, specifically* 29 U.S.C. § 1301(a)(16) (referring to 26 U.S.C. § 401(a)(2)); and Title III (relating to coordination of jurisdictional, administrative, and enforcement issues between the PBGC, the Internal Revenue Service ("IRS"), and the Department of Labor ("DOL")), 29 U.S.C. §§ 1201-1242.

[33] When appropriate, PBGC consults with the other ERISA agencies, IRS and DOL, to ensure consistent interpretation of provisions administered by those agencies.

[34] *See Vanderkam v. PBGC*, No. 09-cv-1907 (RLW), 2013 WL 1882329 (D.D.C. May 7, 2013) (enforcing a determination about a Qualified Domestic Relations Order, which required interpretation of ERISA Title II provision); *PBGC v. Wilson N. Jones Mem'l Hosp.*, 250 F. Supp. 2d 676, 682 (E.D. Tex. 2003) (concluding "that PBGC's views on the issues in this [standard termination enforcement] case which required interpretation of Title II ERISA provisions are entitled to deference"), *aff'd*, 374 F.3d 362 (5th Cir. 2004). *See generally Beck v. Pace Int'l Union* , 551 U.S. 96, 104 (2007) ("We have traditionally deferred to the PBGC when interpreting ERISA, for 'to attempt to answer these questions without the views of the agencies responsible for enforcing ERISA, would be to 'embar[k] upon a voyage without a compass.'") (citation omitted); *Davis v. PBGC*, 571 F.3d 1288, 1293 (D.C. Cir. 2009) ("[W]e defer to the PBGC's authoritative and reasonable interpretations of ambiguous provisions of ERISA."); *Boivin v. U.S. Airways, Inc.*, 446 F.3d 148, 154-57 (D.C. Cir. 2006) (deference applies to PBGC's interpretations of statutory and regulatory provisions); *Sara Lee v. ABA Retirement Plan*, 512 F. Supp. 2d 32, 37 (D.D.C. 2007) (granting deference to PBGC on an issue of plan classification under Title IV of ERISA); *Piggly Wiggly S., Inc. v. PBGC*, Nos. CV94-H-1648-S, CV94-H-1952-S, 1995 U.S. Dist. LEXIS 21934, at *14 (N.D. Ala. Apr. 4, 1995) (enforcing PBGC's standard termination determination requiring interpretation of provisions of Title II of ERISA), *aff'd*, 82 F.3d 430 (11th Cir. 1996). At a minimum, if the Court determines that neither *Chevron* nor APA deference applies, PBGC is entitled to *Skidmore* deference. *See*

II. Because the PPA Amendment was Not Required for Tax Qualification, it Violated 29 C.F.R. § 4041.8

Kentucky Bancshares tells the Court that it paid Plan participants "precisely" what they were entitled to receive under the Plan. (Appellant's Br. at 35). But a Title IV standard termination requires the payment of all benefit liabilities determined under the plan's provisions in effect on the plan's termination date. 29 U.S.C. § 1341(b)(1)(D). On that date, the Plan provisions required lump sums to be calculated using GATT Assumptions, entitling participants who elected lump sums to receive a total of $1.3 million more than they were paid by Kentucky Bancshares. (*See* Cross Motion for Summary Judgment at 5-6, RE 22, Page ID # 98-99).

Kentucky Bancshares also asserts that it did everything necessary to comply with its Plan's provisions and applicable law on the Plan's termination. (*See* Appellant's Br. at 35) But although Kentucky Bancshares chose to amend the Plan

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Gonzales v. Oregon, 546 U.S. 243, 268-269 (2006). *Cf. Sun Capital Partners III, LP v. New England Teamsters & Trucking Indus. Pension Fund*, 724 F.3d 129, 140-41 (1st Cir. 2013) (applying *Skidmore* deference to a PBGC appeals board decision requiring the interpretation of ERISA Title II provisions to enforce Title IV). Under *Skidmore*, the agency's interpretation is "entitled to respect" in proportion to its "power to persuade." *Skidmore v. Swift Co.*, 323 U.S. 134, 140 (1944). The degree of deference to the agency depends on "the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control." *Id.* Each of those factors dictates deference here.

to allow lump sums before termination, it failed to replace the GATT assumptions for calculating lump sums with PPA Assumptions before its selected date of Plan termination. (*See* DB Termination Amendment, Appellant's App., p. 64).

Kentucky Bancshares took this course of action despite (1) Title IV's prohibition on benefit reducing post-termination amendments, *see* 29 C.F.R. § 4041.8; (2) Title IV's requirement that benefits be calculated under the Plan's provision in effect on the Plan's termination date, *see id.*; 29 U.S.C. § 1102(a)(1); (3) PPA's failure to provide relief from Title IV, *see* PPA, Pub. L. 109-280, § 1107; and (4) PBGC's well-reported stance on this issue, *see* Employee Plan News, Vol. 7 (Spring 2007) at 12 and *supra* n.6. (*See* Request for reconsideration, Appellant's App., p. 78).

Having engineered the situation they find themselves in, Kentucky Bancshares tells the Court that "PBGC acknowledges it would have been totally fine with the amounts distributed to Kentucky Bancshares' employees if the [PPA A]mendment had been signed . . . [on the day before the Plan's termination date]." (Appellant's Br. at 35). But Kentucky Bancshares ignores PBGC's mandate to ensure that in a standard termination, plan participants receive the benefits to which they are entitled on the date of Plan termination. *See* 29 C.F.R. § 4041.8; 29 U.S.C. § 1341(b)(1)(D). The law is clear that in addition to the public,

". . . an agency is bound by the regulations it promulgates . . .",[35] and its interpretation of those regulations is "controlling unless plainly erroneous or inconsistent with the regulation.[36]

Kentucky Bancshares, nonetheless, says PBGC's interpretation of its regulation is arbitrary and capricious, and contrary to PPA § 1107, because the benefit decrease made by the PPA Amendment purportedly falls within the § 4041.8 exception for decreases "necessary to meet a qualification requirement under section 401 of the [I.R.C.]." (*See, e.g.* Appellant's Br. at 23-24, 27-28, 31). According to Kentucky Bancshares, under PPA § 1107, the fact that the Plan paid two Plan participants lump sums calculated using PPA Assumptions before the Plan's termination date prevented adoption of any amendment other than the PPA Amendment (Appellant's Br. at 14, 27-28). It attempts to support its claim by noting that PPA § 1107 required plans to be operated as if their retroactive PPA amendments were in effect from the applicable PPA effective date until the date those amendments were adopted. PPA, Pub. L. 109-280, § 1107. Thus, Kentucky Bancshares argues, having paid two PPA lump sums before making the PPA Amendment, it had to adopt an amendment that only allowed payment of PPA lumps sums. This reasoning, however, ignores the purpose of PPA § 1107.

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[35] *Shalala v. Guernsey Mem'l Hosp.*, 514 U.S. 87, 110 (1995).

[36] *United States v. Black*, 739 F.3d 931 (6th Cir. 2014).

PPA § 1107 allowed plans to adopt the new PPA minimum assumptions, which generally produce lower lump sum benefits than GATT Assumptions, without violating the I.R.C.'s and Title I's anti-cutback provisions. And because most PPA amendments would likely be adopted after PPA's January 1, 2008 effective date, PPA § 1107 ensured that amendments permitted by PPA would be deemed timely adopted and that plans would be deemed to have operated in accordance with their PPA amendments before adopting those amendments. PPA § 1107 provided this relief by allowing PPA amendments to be adopted before January 1, 2009, and retroactive to PPA's applicable effective date, as well as requiring that plans be operated as if their retroactive PPA amendments were in effect before their adoption.

Nothing in PPA, however, prohibited a plan from paying lump sums greater than those provided by PPA minimums. In fact, if a plan adopted assumptions for calculating lump sums that complied with PPA, but resulted in benefits with present values greater than lump sums calculated using the a PPA minimums, the PPA § 1107 exception from the anti-cutback provisions of I.R.C. § 411(d)(6) and ERISA § 204(g) would be irrelevant, because the plan did not reduce anyone's benefit. Nor would such payments result in the plan's failing to comply with its terms either before or after making its PPA amendment because it would be paying

GATT lump sums (as the plan promised) before being amended, and the greater of GATT or PPA lump sums (pursuant to its terms) after being amended.

IRS's guidance confirms that PPA § 1107 was not meant to stop plans from paying lump sum benefits greater than those provided by the new PPA minimums. *See* IRS Notice 2008-30, 2008-12 I.R.B. 638. The Notice specifically provides that any necessary "relief under § 1107 of PPA '06 applies to an amendment that provides the more favorable to participants of an amount calculated by using . . . [PPA Assumptions or GATT assumptions]." *See id.* at A-17. This guidance does not exclude adoption of such amendments by plans that may have paid participants PPA lump sums before enacting a PPA amendment to pay the greater of PPA or GATT lump sums. Simply topping up those participants' benefits to GATT levels would be in compliance with the terms of the plan before, or after, a PPA amendment adopting the greater of PPA or GATT assumptions. *See, e.g., id.* at Section IV.

Thus, PPA § 1107 did not require, as Kentucky Bancshares insists, that only its PPA Amendment would meet its criteria for PPA compliance relief. (Appellant's Br. at 27). Even, assuming *arguendo*, that PPA § 1107 required that a "greater of" amendment specifically account for any PPA lump sums paid before adopting that amendment, the Plan could have made such an amendment, and complied with PPA § 1107's operational compliance requirement. For instance, had the Plan been amended to provide for PPA lump sums pre-amendment, and the greater of GATT or PPA lumps sums post-amendment, as well as additional lump sums equal to any difference between PPA and GATT lump sums paid to retirees post-amendment, the plan would have been run "as if such plan . . . amendment had been in effect . . ." before its adoption. Sponsors always have the right to amend their plans to provide additional benefits.[37] PPA § 1107's relief was not meant to curtail that right. Kentucky Bancshares provides no evidence to the contrary.[38] PPA § 1107 did not specify how an amendment had to be worded to comply with the plan's operations before its adoption. Because Kentucky Bancshares submitted only the PPA Amendment to the IRS for qualification purposes, it gave IRS no reason to address whether another amendment that avoided violating PBGC's regulation 4041.8 met I.R.C. qualification requirements.

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[37] There are limited exceptions where additional payments would run afoul of the antidiscrimination rules, which are not at issue here. *See, e.g.,* 26 U.S.C. § 414(v)(4).

[38] Kentucky Bancshares also quotes from IRS Revenue Ruling 2007-67, and the Technical Explanation of the Pension Protection Act (Appellant's Br. at 21-23 and 25-26), supposedly to lend understanding to the purpose of PPA § 1107. Kentucky Bancshares' selective quoting, however, only states what PPA § 1107 said -- that plans may delay adopting the new I.R.C. § 417(e) minimum assumptions until the last day of the first plan year beginning on or after January 1, 2009, that the amendments may be retroactive, and, if PPA §1107 applies to those amendments, the plan will not violate I.R.C.'s and Title I anti-cut back provisions. As we note above, PPA § 1107 did not prohibit an amendment adopting rates that provided participants with greater benefits than those calculated using the minimum assumptions.

Contrary to Kentucky Bancshares' contentions (Appellant's Br. at 28-29), PBGC's did consider its argument that the PPA Amendment was the only permissible post-termination amendment in the administrative record. (Letter responding to request for reconsideration, Appellant's App., pp. 101-02) (rejecting Kentucky Bancshares' argument that the PPA Amendment was necessary to meet tax qualification). PBGC stated in its final determination, as it did in its briefs, that a plan may pay more than § 417(e) minimums, and that "while the Plan had to be amended to provide that lump sums could not be less than those determined using PPA rates, it did not have to be amended to eliminate lump sums greater than those produced using PPA rates." (Letter responding to request for reconsideration, Appellant's App., p. 102). Accordingly, PBGC's final determination was not arbitrary and capricious. (*See id.*, Motion for Summary Judgment at 20-21, RE 19, Page ID # 82-83, and Opinion & Order at 16-17, RE 27, Page ID # 288-89).

In the context of a standard termination, Congress made PBGC responsible for ensuring that plan participants receive the benefits that their plan provisions provide for as of the date of plan termination. 29 U.S.C. § 1341(b)(1)(D). In a standard termination, the plan sponsor specifies the plan termination date, 29 U.S.C. § 1348(a)(1), which sets a finite point in time as of which plan benefits must be calculated. 29 U.S.C. § 1341(b)(1)(D); § 1341(b)(3). And PBGC's regulations prohibit post-termination amendments that reduce benefits.[39]

PBGC's regulation provides an exception for the rare circumstances when post-termination amendments might be required to avoid plan disqualification, because disqualification can have severe negative consequences for participants and sponsors. To date, however, PBGC is not aware of any standard termination where a post- termination amendment that reduced participants' benefits was required for tax qualification purposes. Nor does this case present the rare circumstance where such an amendment would be necessary.

As PBGC's final determination found, and the district court upheld, the PPA Amendment was not the only post-termination amendment that Kentucky Bancshares could have adopted to maintain the Plan's tax qualification. Thus, the PPA Amendment was not "*necessary* to meet a qualification requirement under section 401 of the Code." *See* 29 C.F.R. § 4041.8(c)(1) (emphasis added). Consequently, the Plan participants are entitled to the GATT lump sum benefits provided under the Plan's terms on its termination date.

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[39] By contrast, an ongoing plan remains funded and available to satisfy any future benefit liabilities or successful claims for past liabilities.

CONCLUSION

For the foregoing reasons, this Court should affirm the District Court's ruling finding that the PBGC's final determination was not arbitrary or capricious and was in accordance with the law.

Dated: September 4, 2014

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief contains 7, 664 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).
2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Word in 14-point Times New Roman.

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CERTIFICATE OF SERVICE

I certify that on this 4th day of September, 2014, pursuant to 6 Cir. R. 25, the foregoing Brief of Plaintiff-Appellee was served electronically on the following through the ECF system.

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DESIGNATION OF RELEVANT DISTRICT COURT DOCUMENTS

The following filings from the district court's record are relevant documents:

CIVIL DOCKET FOR CASE #: 5:13-cv-00143-KSF		
Record Entry No. (RE)	**Page ID #**	**Description of Entry**
6	None	Sealed Administrative Record
19	82-83	Motion for Summary Judgment by Pension Benefit Guaranty Corporation
22	98-116	Cross Motion for Summary Judgment by Kentucky Bancshares, Inc.
25	230-35	Reply to Motion for Summary Judgment by Pension Benefit Guaranty Corporation
27	286-89	Opinion & Order