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INTRODUCTION

In 1875, the American Express Company established a private, noncontributory pension plan for its employees, the first such plan in North America. This plan, and those established in the ensuing years, was a response to the social upheavals of the Industrial Revolution. Primarily, the new urban family structure no longer provided for care of the aged as the rural family had done. Society therefore looked to industry to fill this gap, by means of the private pension system. Private pension funds have recently experienced tremendous growth in importance, complexity, and actual monetary value.

Congress perceived a need for legislation in this area and in 1974 enacted the Employee Retirement Income Security Act (ERISA). New legislation, however, often creates an additional dilemma for the courts because questions arise as to the application and interpretation of the law. Since many questions have arisen regarding the interpretation of ERISA, the courts are charged with the responsibility of developing a new federal common law with respect to employee benefit plans.

One such problem for judicial policy-makers arises with respect to pension plan terminations. ERISA insures payment of benefits by means of the Pension Benefit Guaranty Corporation (PBGC) in the event a plan terminates with insufficient assets in relation to its liabilities. However, a plan which terminates with an excess of assets over liabilities is the source of much controversy. ERISA provides for reversion of surplus assets to the employer in specified circumstances, but this provision has been and continues to be challenged frequently in the courts.

This Note discusses the determination of the legal status of surplus pension assets upon termination of Defined Benefit Plans. It begins by tracing the

1. A "noncontributory" plan is one in which the employees themselves make no contributions.
3. For a thorough discussion of the advent of private pensions in the United States, see id. at 27-35.
5. Amato v. Bernard, 618 F.2d 559, 567 (9th Cir. 1980).
6. Private pension plans generally fall into one of two categories: Defined Benefit Plans or Defined Contribution Plans. In the former, the employee's benefit is predetermined by
evolution of the theories behind private pension plans. It next examines the arguments for and against allowing reversion. The Note concludes by suggesting possible solutions to apparent conflicts between the original purpose of ERISA and judicial policy.

I. THE EVOLUTION OF THE LEGAL THEORY OF PRIVATE PENSIONS

Prior to the enactment of ERISA, pension disputes were decided in the courts under a variety of legal theories. Changes in these theories kept pace with changes in society's view of the employer/employee relationship. The earliest pension cases were resolved by applying the gratuity theory, under which pensions were held to be mere gratuities creating no enforceable rights in the employees. The New York Supreme Court first expressed this theory in 1898 in *McNevin v. Solvay Process Co.* Plaintiff McNevin brought suit to recover approximately fifty dollars as his share of his employer's non-contributory pension plan. The court held in favor of the employer, emphasizing the voluntary nature of the defendant's actions in establishing the plan. The court held that only actual payment of a pension benefit would give an employee a vested interest in the fund. Prior to payment, any such benefit remained "an inchoate gift." The gratuity theory prevailed through the early decades of the twentieth century. Early pension plans were almost always construed in favor of the employer. The courts gradually began to express dissatisfaction with the gratuity theory and its extreme pro-employer orientation, and they adopted various theories which recognized that valid consideration for the employer's promise means of a formula utilizing variables such as years of service and earnings. A Defined Contribution Plan requires the employer to predetermine his contributions. Thus, the employee receives a retirement benefit equal to the employer's contributions plus any investment gains or minus any losses. This Note will deal exclusively with Defined Benefit Plans because, by definition, a surplus cannot exist under a Defined Contribution Plan. For a comprehensive comparison of these two plan types, see *EMPLOYEE BENEFIT RESEARCH INSTITUTE, FUNDAMENTALS OF EMPLOYEE BENEFIT PROGRAMS* 41-49 (1983).

8. *Id.* at 612-13, 53 N.Y.S. at 99-100.
10. This dissatisfaction is apparent in the court's opinion in *MacCabe v. Consolidated Edison Co.*, 30 N.Y.S.2d 445 (N.Y. City Ct. 1941):
* [W]here, as here, the retirement Plan is not included in a contract between the employer and employee, the courts are without choice but to hold that the benefits therein described are entirely voluntary and gratuitous on the part of the employer. This conclusion of the law does not necessarily coincide with actuality and in some cases may be so contrary to fact as to shock the conscience of the court that utters it. The law should keep pace with social progress but in the very nature of the judicial process it must be a laggard as courts of original jurisdiction await the lighting of each new torch in our appellate tribunals.

*Id.* at 447 (citations omitted).
SURPLUS PENSION ASSETS

10 to pay pension benefits flowed out of the employment relationship.11 Employees finally were able to enforce contractual rights under noncontributory plans.12

Some courts began to view pension plans as unilateral contracts.13 Adopting a plan of which the employees were aware constituted the offer. Continued faithful employment furnished consideration for the employer's promise to pay pension benefits. Many courts viewed the central purpose of a pension plan as securing a benefit for the employer in retaining the "loyalty and continued service of the employees."14 For the first time, the "reasonable expectations" of the employees15 became a primary consideration.

A similar theory of pensions developed from the same concept of the employer/employee relationship. Courts applying the deferred wages theory characterized pension benefits as compensation for services actually rendered by the employee.16 This partial compensation was deferred as an inducement for the quality service of the employee. The deferred wages theory of pension benefits became the prevailing view among courts until the enactment of ERISA in 1974 and was pervasive enough to be incorporated into the Internal Revenue Service Regulations governing the tax qualification of pension plans.17

II. BRIEF HISTORY AND CONTENT OF ERISA

Although the evolution of legal pension theory moved in a direction favorable to employees' rights, abuses of the pension system were widespread during the years prior to ERISA. The legal doctrines developed by the courts did not solve the problem of pension fund abuses because the rights they recognized were enforceable against the fund, not against the employer.

Even among workers covered by private plans, actual receipt of benefits was by no means assured. A variety of factors contributed to the tenuous nature of pension benefit payments. Only one-third of those workers covered were vested because of stringent vesting standards. Employees, even if vested, had no assurance of actual payment because of the possibility of inadequate funding. Plan administration was sometimes executed dishonestly or unwisely, as in a failure to diversify investments with plan assets. Portfolio

11. See infra notes 12-16 and accompanying text.
15. Id.
17. A "qualified" plan, as defined in 26 U.S.C. § 401, is exempt from taxation under 26 U.S.C. § 501(a) and entitles the employer to deductions for contributions to such plan under 26 U.S.C. § 404 in much the same way as such contributions would reduce taxable income if they were paid as employee compensation in the current period.
appreciation allowed a reduction in employer contributions, but losses were usually borne by plan beneficiaries because a company had no legal obligation to increase contributions. 18

No comprehensive pension legislation existed prior to the promulgation of ERISA. Only three statutes addressed the private pension system in any significant manner. 19 The Labor-Management Relations Act of 1947 (the Taft-Hartley Act)20 addressed the administration of collectively-bargained pension plans and granted special jurisdiction to federal courts over contracts between employers and employee labor organizations, which included pension contracts. The Federal Welfare and Pension Plan Disclosure Act of 195821 was another piece of legislation having only a peripheral effect on the private pension system as a whole. As the title suggests, this legislation required disclosure of pertinent information regarding pension funds, such as a basic "description" and an annual report. Finally, the Internal Revenue Code of 195422 offered the most meaningful pre-ERISA pension regulation by placing restrictions on those plans seeking tax-qualified status. There was, however, widespread sentiment that existing regulations were inadequate in light of the growing magnitude and complexity of the nation's private pension system. 23

The legislative response was ERISA, enacted in September of 1974. ERISA does not require establishment of a plan, but sets forth a comprehensive list of minimum standards to be met in areas such as vesting, funding, and disclosure, should such a plan be established.

The legislative history of ERISA indicates that Congress drafted the statute with several goals in mind. The Act was designed to:

(1) establish equitable standards of plan administration; (2) mandate minimum standards of plan design with respect to the vesting of plan benefits; (3) require minimum standards of fiscal responsibility by requiring the amortization of unfunded liabilities; (4) insure the vested portion of unfunded liabilities against the risk of premature plan termination; and (5) promote a renewed expansion of private retirement planning.

19. For a thorough discussion of these three regulatory acts, see E. PATTERSON, LEGAL PROTECTION OF PRIVATE PENSION EXPECTATIONS 85-108 (1960).
23. During the ERISA hearings, Congressman Joseph Gaydos commented on the inadequacy of the Internal Revenue Code for the regulation of private pensions:
Since the primary function of this law is to produce revenue and prevent tax evasion, enforcement consists in the Internal Revenue Service's grant or disallowance of "qualified status" to a pension plan. Accordingly, there is only a very limited protection for the rights of the participants and beneficiaries of a plan.
plans and increase the number of participants receiving private retirement benefits.\textsuperscript{24}

ERISA was, in short, promulgated for the dual purposes of providing protection for beneficiaries under existing plans and encouraging the growth and development of the private pension system as a whole. Congress did, however, recognize the inherent tension between these two goals. Legislators deemed it important to strike a delicate balance between those constraints stringent enough to adequately protect beneficiaries' rights, and those which allowed enough flexibility of employer discretion that plan creation would not be discouraged.\textsuperscript{25} Any analysis of the provisions of ERISA must, therefore, include due consideration of these conflicting policies.

\section*{III. Termination Provisions Under ERISA}

Although pension plans ideally continue to exist indefinitely,\textsuperscript{26} ERISA does preserve the employer's right of termination. Sections 1301 through 1381 provide plan termination insurance in the form of the PBGC; sections 1341 through 1344 provide actual procedures for plan termination. ERISA provides no statutory definition of plan termination. Thus, the PBGC developed its own definition: in general, a voluntary plan termination occurs when all accruals\textsuperscript{27} have ceased and the plan sponsor has permanently discontinued all contributions to the plan.\textsuperscript{28}

Voluntary terminations may be undertaken for various reasons. A plan may become financially burdensome to its sponsor company,\textsuperscript{29} for example, or the company may wish to sponsor a different type of plan.\textsuperscript{30} The initial action required to begin a voluntary plan termination is a written request to the PBGC for a "notice of sufficiency" of plan assets.\textsuperscript{31} When the notice is received, the employer may terminate the plan and distribute the assets.\textsuperscript{32}


\textsuperscript{26} The "Rule of Permanence" requires that a qualified plan be intended to be permanent. See Treas. Reg. § 1.401-1(b)(2) (1956); Rev. Rul. 69-25, 1969-1 C.B. 113, §§ 2, 3. Termination within a short time of adoption is regarded as evidence that the plan was intended to be temporary, unless contrary evidence can be furnished. See Rev. Rul. 69-25 at § 2.02.

\textsuperscript{27} For a statutory definition of an "accrued benefit," see 29 U.S.C. § 1002(23) (1982).

\textsuperscript{28} D. McGill, FUNDAMENTALS OF PRIVATE PENSIONS 431 (1975).

\textsuperscript{29} See, e.g., Audio Fidelity Corp. v. Pension Benefit Guar. Corp., 624 F.2d 513, 515 (4th Cir. 1980).


\textsuperscript{31} 29 U.S.C. § 1341(a), (b) (1982).

\textsuperscript{32} If the assets are determined to be insufficient, the termination will proceed according to 29 U.S.C. § 1342 relating to involuntary terminations.
More controversial, however, is the situation in which plan assets are of greater value than accrued benefits. In such circumstances, the disposition of the surplus becomes an issue. No actual surplus can exist prior to plan termination because the PBGC will only "officially" value plan assets in response to a notice of an employer's intention to terminate. Although a surplus can probably be quite accurately anticipated and valued by an actuary prior to termination, the surplus itself does not exist until the plan is terminated.

According to ERISA, an employer may recover a surplus only if it is attributable to "erroneous actuarial computation"; that is, if the expected costs of the plan exceed actual costs. Section 1344(d)(1) establishes three additional requirements for reversion: all liabilities of the plan must be satisfied; the plan itself must provide for reversion; and the reversion must not violate any other provision of law. Although the statute therefore expressly provides for reversion, the propriety of surplus recapture should not be taken for granted. The issue requires the weighing of numerous practical and theoretical considerations, which will be discussed in the next section.

IV. SHOULD ANY REVERSION BE PERMITTED?

Whether or not to allow recovery of excess pension assets is a controversy that pre-dates the enactment of ERISA. Prior to ERISA, cases of this type were often decided on principles of trust law. Once the purpose of a trust has been accomplished, any surplus automatically reverts to the settlor. With respect to pension plans, once all vested benefits have been paid, any surplus automatically reverts to the pension sponsor. In the years following promulgation of the Internal Revenue Code, decisions often centered upon satisfaction of Code requirements.

Since the enactment of ERISA, disgruntled beneficiaries continue to challenge an employer's right to surplus reversion. The courts, however, have quite consistently supported the employer's right to recapture, while carving

34. See 26 C.F.R. § 1.401-2(b)(1) (1986).
35. Id.
out only a few exceptions to this policy. Plaintiffs in these cases have raised a variety of questions regarding the propriety of surplus reversion. The courts, unfortunately, have left many of those questions unanswered, or at least have given some rather nebulous answers.

A. The Case Against Reversion

1. The "Reasonable Expectations" Argument

Since the gradual demise of the gratuity theory, a recurring theme of judicial opinions in pension cases has been the protection of "the employees' reasonable expectations of receiving the promised reward." Under this theory, pension plans have become an integral part of the offer of employment since employees reaching retirement age reasonably expect to receive these promised benefits.

The role of employee expectations in the distribution of surplus assets is somewhat more tenuous. Surpluses obviously are not an integral part of an employee's expected compensation. The "reasonable expectations" argument, therefore, is viable only in situations where an employer has taken some action which would create such an expectation in the employee's mind.

This type of situation occurs when the plan document expressly grants the entire corpus of the fund, including any excess due to erroneous computation, to the employees in the event of termination. Although the typical employee will probably not have actual notice of such a provision, ERISA requires that each employee be furnished with a "summary plan description" which must be "sufficiently accurate and comprehensive to reasonably apprise... participants and beneficiaries of their rights and obligations under the plan." Beneficiaries also must be informed of any "material modification in the terms of the plan."

ERISA's strict disclosure requirements thus furnish constructive (if not actual) notice of plan provisions to all employees. If an employee knows or should know the provisions of the pension plan, and that the plan expressly grants any excess assets to the participants, then the employee can reasonably expect to receive a share of the surplus upon termination.

41. The most common such exception is that employers may not recapture a surplus if retroactive (i.e., after termination) plan amendments are used to do so. See Audio Fidelity Corp. v. Pension Benefit Guar. Corp., 624 F.2d 513 (4th Cir. 1980).
43. See E. PATRINGTON, supra note 19, at 4-5.
44. See, e.g., Walsh v. Great Atl. & Pac. Tca Co., 726 F.2d 956, 959 (3d Cir. 1983) (plan originally granting any surplus to company amended to grant all funds to plan members in event of termination).
46. Id.
The forerunner of the "reasonable expectations" theory is the doctrine of estoppel, which was often used in pre-ERISA cases. In *Lynch v. Dawson Collieries, Inc.*, the defendant employer ceased business operations and terminated its pension plan. A booklet provided to the members stated that any surplus which might accrue in the plan would be distributed to the employees. Plaintiff argued that defendant should be estopped from recapturing the surplus on the basis of these statements.

The *Lynch* court rejected this argument on two grounds. First, the court found no evidence that any participant(s) suffered a detriment in reliance on these statements. Second, because plan contributions were "wholly voluntary on the part of the company," the court reasoned that the company could have ceased contributions at any time, leaving no basis for an employee to expect that a surplus would ever arise.

Leaving aside any discussion regarding the soundness of the reasoning in *Lynch*, the court's opinion supplies a framework through which modern "reasonable expectations" theory may be analyzed. Consider the court's statement that plaintiffs failed to provide evidence of reliance on the promise of receiving a share of the surplus. Under "reasonable expectations" doctrine, the role of reliance is greatly reduced. In fact, New Jersey courts have eliminated the requirement of reliance completely in applying the "reasonable expectations" doctrine to insurance policy disputes as well as to pension plans.

ERISA itself eliminates the rationale behind the *Lynch* argument that the employer could have stopped its voluntary plan contributions at any time. Once established, pension plans are no longer "wholly voluntary" and completely subject to the employer's will. A post-ERISA plaintiff facing the fact situation presented in *Lynch* has a strong argument using the "reasonable expectations" doctrine.

Recent cases, however, have not presented an opportunity to fully test the merits of the "reasonable expectations" theory. Plaintiffs in *Van Orman v. American Insurance Co.* for example, raised the "reasonable expectations"
argument. Plan participants in *Van Orman* were furnished with a booklet purporting to provide a "detailed explanation" of the plan. The booklet stated that in "the event the Plan is terminated, all funds held in trust will be used for the benefit of retired employees and active Participants and the Beneficiaries of deceased employees." The booklet also contained a disclaimer to the effect that all statements therein were "qualified by reference to the Plan itself." The plan document granted any surplus existing upon termination to the company.

Plaintiffs did not prevail on their claim to recover this surplus. In light of the disclaimer, there is little question about the propriety of this holding. The opinion states that the disclaimer served as adequate notice to plan participants that only the official plan document, not the booklet, governed their rights. The *Van Orman* decision, however, leaves open the question as to whether, in the absence of proper notice such as the disclaimers, the plaintiff might have prevailed on the "reasonable expectations" theory.

The expectations doctrine, although beneficial to plaintiffs in situations similar to *Lynch*, falls short as the sole justification for refusing to allow surplus reversions. As is apparent in *Van Orman*, not all employers make representations regarding the disposition of surplus assets which would lead an employee to a reasonable expectation of receiving such a sum. In addition, the viability of the "reasonable expectations" argument in the case against reversion is substantially lessened by the reluctance of the majority of courts to accept the New Jersey courts' doctrine of not requiring detrimental reliance.

2. The Legislative Purpose Argument

The enactment of ERISA in 1974 signalled a change in public policy with respect to private pensions. The change was one of focus—from regulation primarily for purposes of tax considerations, to regulation emphasizing concern for employee security. A basic goal of the Act is to encourage the
continuation and maintenance of these plans. A fundamental premise in the area of pension law provides that a plan must be formed with the intent that it be permanent. Any policy which makes termination attractive to plan sponsors, therefore, will undermine legislative intent.

ERISA’s relatively lenient minimum standards for reversion and consistent judicial support of employer claims in the area can be construed as incentives to terminate. Pension funds containing potential surplus offer plan sponsors an easily accessible source of cash. Unconditional legislative and judicial sanction of surplus recapture, therefore, arguably makes the option of termination more attractive to the plan sponsor than stable maintenance of one continuous plan.

The vital question, however, is not whether lenient reversion standards lead to increased terminations, but rather whether terminations harm the pension beneficiaries which ERISA purports to protect. Congressional hearings on pension legislation pointed out that pre-ERISA terminations often resulted in lost employee benefits. Although ERISA eliminated many of the causes of these losses through strict participation and vesting requirements, minimum funding standards and creation of the PBGC, termination still presents certain risks to plan participants.

One manner in which plan terminations may adversely affect beneficiaries is that a plan sponsor may replace a terminated Defined Benefit plan with a plan that inadequately protects employees’ retirement benefits. For the last forty years, Defined Benefit plans have been the dominant plan form. A recent trend, however, is towards terminating these plans to establish Defined Contribution plans. The Defined Contribution plan transfers the risks of poor fund performance to the employee and makes the level of future retirement income a virtual unknown for the pre-retirement worker. An employee who is subjected to increased financial risk and uncertainty clearly has suffered a detriment.

It is also argued that increasing the number of plan terminations decreases the likelihood that new plans of any kind will be adopted to replace the old ones. Re-establishing a plan following termination is a complex, time-

63. See supra text accompanying notes 33-34.
64. A 1972 study by the Departments of Labor and the Treasury indicated that 1227 plans terminated that year involving 42,000 participants, of whom 19,500 lost benefits amounting to over $48.7 million. 120 Cong. Rec. 29,195 (daily ed. Aug. 20, 1974).
66. Id. at §§ 1081-86.
67. Id. at §§ 1301-80.
69. See supra note 6; Hickerson v. Velsicol Chemical Corp., 778 F.2d 365, 370 n.9 (7th Cir. 1985).
consuming, and costly process, which might lead to an employer's reluctance to set up a new plan after each termination. If this is true, terminations harm plan beneficiaries in an even more profound manner.

In summary, one can argue against allowing surplus reversion by pointing out that a primary concern of Congress in adopting ERISA was the stability and maintenance of pension plans. Current judicial interpretation of ERISA places few if any restrictions on an employer's right to recapture surpluses, and thus seems to encourage termination. Employees seldom, if ever, benefit from a termination and often suffer a detriment as a result. This presents a fundamental conflict between legislative intent and judicial policy.

3. The Exclusive Benefit Argument

Section 1103(c)(1) of ERISA provides that "the assets of a plan shall never inure to the benefit of any employer and shall be held for the exclusive purposes of providing benefits to participants in the plan and their beneficiaries and defraying reasonable expenses of administering the plan."[71] Even prior to the enactment of ERISA, the Internal Revenue Code placed the same restriction on plans seeking tax-qualified status.[72] The origin of this rule of fiduciary conduct is readily apparent in light of the legislative intent behind ERISA:[73] to establish permanent, stable plans which are managed in such a way as to protect the rights and interests of the participants.

A recent trend in the area of plan terminations has been termination and surplus recapture for a "variety of corporate purposes."[74] A corporation may, for example, use its plan surplus to increase liquidity, to carry out a stock repurchase as an anti-takeover device, or to reduce a burdensome level of debt.[75] The inherent nature of the phrase "corporate purposes" suggests a conflict with ERISA's fiduciary standards. A final argument against allowing reversion, therefore, is that the prospect of surplus recapture encourages termination for the sole purpose of benefitting the employer. Such terminations clearly cause plan assets to "inure to the benefit of [the] employer,"[76] and thus violate the exclusive benefit rule.

72. 26 U.S.C. § 401(a)(2) (1982) states that a trust is not qualified unless:
   if under the trust instrument it is impossible, at any time prior to the satisfaction
   of all liabilities with respect to employees or their beneficiaries under the trust,
   for any part of the corpus or income to be (within the taxable year or thereafter)
   used for, or diverted to, purposes other than for the exclusive benefit of his
   employees or their beneficiaries . . . .

Id.
73. See supra text accompanying notes 60-66.
74. Gaver & Freilich, supra note 69, at 54.
75. Id.
76. 29 U.S.C. § 1103(c)(1).
The exclusive benefit rule is a fiduciary standard. Therefore, in order to apply the exclusive benefit rule in the context of plan terminations, the decision to terminate must be classified as a fiduciary decision. An obvious counterargument is that the decision to terminate an employee benefit plan is not a fiduciary decision.\(^7\) This viewpoint, however, conflicts with congressional intent in the area of plan fiduciaries. The Joint Explanatory Statement of the Committee of Conference defines a fiduciary as: "any person who exercises any discretionary authority or control respecting management of a plan, exercises any authority or control respecting the management or disposition of its assets or has any discretionary authority or responsibility in the administration of the plan."\(^7\) Under this broad definition, it is certainly conceivable that Congress intended that those individuals with the power to terminate a plan be construed as fiduciaries under ERISA. Although the legislative history of statutes such as ERISA may be open to various interpretations with respect to determining congressional intent, the courts must nevertheless give significant consideration to such express legislative intent.

The PBGC utilized the exclusive benefit argument in In re *C.D. Moyer Co. Trust Fund.*\(^7\) In *Moyer*, the PBGC sought to appoint a trustee to allocate a surplus arising from the termination of a plan sponsored by the company, based on the belief that the employer had provided for surplus reversion by means of an improper plan amendment.\(^8\) The plan itself contained a provision quite similar in wording to ERISA's exclusive benefit rule.\(^8\) The PBGC based its argument in large part on the contention that part of the trust corpus or income was improperly diverted to the employer's benefit in contravention of this provision. In rejecting the PBGC's reasoning,\(^8\) the court presented yet another obstacle to the exclusive benefit argument. In the court's opinion, "the phrase 'trust corpus or income' means only such funds that are necessary to insure the Plan's specified obligations to the participants."\(^8\) Although the *Moyer* court was not inter-

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77. See Gaver & Freilich, *supra* note 69, at 53-54.
80. *Id.* at 1130.
81. The Plan contained the following provision in paragraph 5.1:
   It shall, however, at all times be impossible, if any alteration, amendment or revocation be made pursuant to this provision, for any of the trust corpus or income to be diverted to or revert to either of the employers or to be used for any purpose other than the exclusive benefit of the participants or their beneficiaries.
   *Id.* at 1131 (emphasis added).
82. Courts generally uphold a plan sponsor's right to amend. Recently, however, the United States Court of Appeals for the Third Circuit held that unilateral amending of a plan to provide for reversion is a breach of the employer's fiduciary duty under ERISA where the pension agreement does not expressly allow amendment. Delgrosso v. Spang & Co., 769 F.2d 928, 935 (3d Cir. 1985).
83. *Id.* at 1132.
interpreting ERISA per se, this reasoning may be applied to similar wording in ERISA's exclusive benefit rule to determine that surplus assets do not receive the protection of the rule.84

A New Jersey district court applied this reasoning when interpreting ERISA in Esteves v. GAF Corp.85 Plaintiff argued that an amendment granting any surplus to the employer was invalid because of the exclusive benefit rule. The court disagreed, however, saying that only the assets needed to satisfy formula benefits—those benefits computed in the plan—are referred to by the exclusive benefit rule.86

No matter how the courts decide to interpret the exclusive benefit rule with respect to what benefits are protected, they must do so with consistency. This is true whether or not surplus assets are included. ERISA makes no attempt to clarify this issue, and there are equally persuasive arguments on either side.

*Holliday v. Xerox Corp.*87 explores another facet of the exclusive benefit argument. In *Holliday*, defendant employer transferred funds from one pension fund to another, using these funds as a "setoff" in calculating the benefits to which each employee was entitled under a new guaranteed minimum income plan.88 The transfer effectively reduced the amount of employer contributions necessary to fund the plan. Plaintiffs argued that ERISA prohibits any actions affecting plan assets which benefit the employer in any way. The court, however, found "no violation of either the letter or the spirit of ERISA,"89 as it considered the transfer to have the "obvious primary purpose and effect of benefitting the employees, and in addition the incidental side effect of being prudent from the employer's economic perspective."90

The *Holliday* opinion leaves an important question unanswered. It is unclear what effect, if any, the exclusive benefit rule has in cases where the employees are neither benefitted nor harmed, and the employer receives the sole benefit of the transaction. Such actions appear inconsistent with the

84. For a variation on this argument, see Washington-Baltimore Newspaper Guild Local 35 v. Washington Star Co., 555 F. Supp. 257 (D.D.C. 1983). The Trust Agreement in *Washington Star* contained language quite similar to ERISA's exclusive benefit language. Plaintiffs argued that the exclusive benefit rule is not applicable to plan surpluses but rather is "designed to protect against diminution or loss of anticipated, defined benefits." Id. at 260 (emphasis added). The court was persuaded by this reasoning. It held that it was unclear whether the Trust Agreement language at issue was meant to apply to surplus funds, or was "intended to merely incorporate the exclusive benefit rule . . . ." Id. at 261 (emphasis added). The court seems to have accepted plaintiffs' argument that ERISA's exclusive benefit provision does not apply to surpluses.


86. Id.

87. 732 F.2d 548 (6th Cir. 1984).

88. Id. at 549.

89. Id. at 551.

90. Id.
basic fiduciary concept. Plan fiduciaries must operate with "an eye single"91 to the welfare and interests of plan participants. If the courts wish to maintain a pure fiduciary standard with respect to pension asset management, they must prohibit manipulation of plan assets for the sole benefit of the employer. Plan terminations motivated strictly by the prospect of surplus recapture are questionable in light of ERISA's exclusive benefit rule. An example of this type of termination is the case of termination as an anti-takeover tactic. When recaptured surplus funds are used to perform a stock repurchase, the transaction is clearly performed in the interests of the plan sponsor. It is difficult to reconcile this result with ERISA's "exclusive benefit" language. Arguments against reversion based on this provision of ERISA warrant more thorough treatment in the courts than they have been given up to the present.

B. The Case for Reversion

1. The Law of Trusts

Prior to the enactment of ERISA, the courts looked primarily to trust law in cases involving employee benefit plans. When a dispute arose regarding surplus assets, the courts considered the fund a fully performed trust with excess assets remaining. The law of trusts dictates that the transferor in such a case is entitled to the surplus unless he has "properly manifested an intention" to the contrary.92 Pre-ERISA cases in the area of surplus assets were thus overwhelmingly decided in favor of the employer, based upon trust principles.93 If post-ERISA pension plans are to continue to be viewed as trusts, then the law governing them should at least be compatible with common law trust principles. In Pollock v. Castrovinci,94 the court supported its holding which allowed surplus reversion by stating that reversion is "consistent with the general rule of trusts . . . ."95

The strength of this argument as a rationale for allowing reversion is tempered by the fact that ERISA was intended to preempt all state law, statutory as well as common, in the area of employee benefit plans.96 Any policy adopted by the courts should be based primarily upon interpretation

92. RESTATEMENT (SECOND) OF THE LAW OF TRUSTS, supra note 37, at § 430.
95. Id. at 616.
of the language of the statute itself.\(^9\) Although the common law policies existing at the time of the statute’s enactment can provide valuable insight into the purpose of the statute and its application,\(^9\) the words of the statute should be conclusive absent congressional silence or ambiguity on a particular issue.\(^9\)

2. Effects on the Private Pension System

Proponents of surplus reversion frequently contend that any policy which significantly reduces allowable reversions to plan sponsors will result in undesirable consequences for the pension system as a whole. There are several facets to this argument favoring reversion.

It is argued that prohibiting reversion would fundamentally alter the basic tenets of the private pension system. At present, participation by employers is completely voluntary. ERISA prescribes only minimum standards to be met once a plan is established. Termination of a pension plan, although supervised by the PBGC, is also a voluntary decision for the employer. In general an employer is, and always has been, entitled to free entry into the pension system and exit from it. This principle has been said to lie “at the very heart of our pension system.”\(^1\)

Prohibiting reversion might significantly decrease the amount of employer discretion involved in plan terminations. This, however, depends upon the manner in which reversions are eliminated. Certainly any proposal that makes termination difficult where a potential for surplus exists, or that eliminates terminations altogether,\(^1\) places severe restrictions on plan sponsors. These proposals should be scrutinized with extreme care. Such methods would probably have adverse effects on the pension system as a whole, as employers would become increasingly reluctant to establish an effectively “irreversible” plan.

\(97\) 2A J. SUTHERLAND, SUTHERLAND STATUTORY CONSTRUCTION § 45.01 (1984) ("When an authoritative written text of the law has been adopted, the particular language of the text is always the starting point on any question concerning the application of the law."); see also GAF Corp. v. Milstein, 453 F.2d 709, 716 (2d Cir. 1971) (the "first catechism of statutory construction" is to begin with the language of the statute itself). But see Cooper v. Argonaut Ins. Co., 556 P.2d 525, 526 (Alaska 1976) (court can adopt a position to effect legislative intent to reach an equitable result even though literal statutory language lends itself to an opposite outcome).

\(98\) See J. SUTHERLAND, supra note 97, § 50.01.

\(99\) See id. ("In cases of conflict between legislation and the common law, legislation will govern because it is the latest expression of the law. Where the language of the statute is subject to reasonable doubt, reference to common-law principles may provide a valuable clue as to whether a particular situation is controlled by the statute.") (footnote omitted). But see Milstein, 453 F.2d at 716 (failing to utilize relevant aids to construction beyond the language of the statute would “close off the only light available to illumine the statute,” even absent ambiguity).

\(100\) Gaver & Freilich, supra note 69, at 54.

\(101\) For a discussion of one such proposal, see id.
There are, however, other less extreme ways in which reversions may be prevented which would have lesser effects on the actual termination decision. The PBGC and the courts, for example, might be given an increased role in deciding the true nature of the surplus—whether it arose from intentional overfunding or from "erroneous actuarial computations." This determination would be independent of the employer's initial decision to terminate the plan. Determinations by external sources obviously would have some effect upon the desirability of termination. Under such a policy, however, employer independence regarding entry to and exit from the private pension system would suffer minimal harm.

Perhaps a more valid concern regarding the effects of preventing reversions is that minimal funding of plans might be encouraged. Several post-ERISA decisions in this area have stressed the importance of allowing reversions so that the employer will not be "penalized for overfunding in 'an abundance of caution.'" A penalty for overfunding almost certainly would encourage employers to contribute the smallest possible amount to the fund, thus increasing the incidence of underfunded plans. Although the PBGC is designed to protect employees from the dangers of underfunded plans, underfunding is clearly an undesirable result, and certainly not one to be encouraged by the courts.

Finally, there is also substantial concern that prohibiting reversions will cause employers to shift from Defined Benefit plans to Defined Contribution plans. The reason is simple: if a sponsor cannot reap the benefits of actuarial errors in its favor, then it will have little reason to bear the risks of unfavorable actuarial errors. Under a Defined Contribution plan, the employees bear the risk of economic downturns and are faced with uncertain retirement incomes.

A primary purpose of ERISA is to encourage maintenance of pension plans, not to so severely restrict employers that they will be discouraged from maintaining plans at all. The probable adverse effect on the maintenance of securely-funded Defined Benefit plans is, therefore, a compelling argument in favor of allowing surplus reversion.

3. The Equity Argument

Another argument commonly offered in support of reversion is one based upon equity principles rather than on statutory interpretation. This argument, in essence, maintains that, in light of the risks faced by a plan sponsor, principles of fairness require that any surplus due to inadvertent overfunding revert to the employer.

102. Moyer, 441 F. Supp. at 1132-33; see also Holliday, 732 F.2d at 552.
103. See supra note 6.
104. See text accompanying note 68.
Specifically, in the event a plan terminates with assets insufficient to satisfy its liabilities, the PBGC will pay all nonforfeitable,\textsuperscript{105} basic\textsuperscript{106} benefits within certain legal limits.\textsuperscript{107} Any loss incurred by the PBGC in meeting the benefit obligations of a terminated plan will obligate the employer to reimburse the PBGC in full up to thirty percent of the net worth of the company and its subsidiaries.\textsuperscript{108} The presence of the PBGC thus insulates the employees from the risks of financial uncertainty, but does not protect the employer. Should a plan terminate, however, with assets more than sufficient to satisfy its liabilities and reversion is prohibited, the employer is left with no benefit in return for bearing the risk of poor asset performance or higher than anticipated costs. This is, essentially, a “no-win” situation for the employer.

It is also obvious that if each employee had bargained for his pension agreement directly with the employer, the latter would never have assented to the formation of a contract under which he bears all the risks of inferior plan performance but reaps no benefits from superior plan performance. It is also arguable that if the parties never would have agreed to a contract provision which eliminated reversion, it would be inequitable for the courts to imply such a provision in pension disputes.

On the other hand, the equity line of reasoning raises the question of how much benefit, if any, an employer should receive by maintaining a plan. The argument that any surplus should revert to the employer as compensation for risk ignores the fact that the employer is already benefitting from the mere existence of the plan. At least in theory, a pension plan attracts quality employees and forms part of the compensation “package,” thereby reducing the actual wages which the employer must pay.\textsuperscript{109} Any surplus reversion would be an additional benefit to the employer, beyond that which fairness requires. Principles of equity alone, therefore, are not sufficient to justify reversion.

V. Proposals

The preceding brief survey of the common arguments for and against surplus reversion demonstrates why this issue has been the subject of widespread controversy since the enactment of ERISA. Judicial policy in the area of surplus reversions may be viewed as a continuum of varying degrees of stringency. At one extreme, the courts would unconditionally prohibit

\textsuperscript{105} The term “nonforfeitable” is defined at 29 U.S.C. § 1002(19) (1982).

\textsuperscript{106} A concise definition of a “basic” benefit is found at 26 U.S.C. § 401(j)(5) (the Internal Revenue Code) (repealed 1982).

\textsuperscript{107} 29 U.S.C. § 1322(b)(3) (1982) prescribes formulas by which these limits may be computed.


\textsuperscript{109} See supra text accompanying note 16 describing the deferred compensation theory of pensions.
reversion; at the other, reversion would be permitted regardless of the circumstances. The disadvantages of prohibiting reversion entirely\textsuperscript{110} outweigh the advantages that might be gained thereby. The dangers of harming the stability of the entire pension system are substantial when one considers the probable reaction of employers to a total prohibition on surplus reversions.

The recent enactment of the Tax Reform Act of 1986 may prompt some to contend that this issue is moot. Arguably, Congress has recognized the problem and resolved the issue. Section 1132 of the 1986 Act imposes a ten percent excise tax on all pension asset reversions resulting from terminations occurring after 1985.\textsuperscript{111} However, the ten percent excise tax will likely be more effective in deterring terminations of plans containing relatively small surpluses than large ones.\textsuperscript{112} Although, relatively speaking, the tax deprives both employers of an equal percentage, practically speaking, an already small surplus becomes hardly worth the administrative "hassle" of recapture after a ten percent tax.

Therefore, despite Congress' recent attempt to address the issue, a move in the direction of judicial stringency is still indicated. Tighter scrutiny of surplus reversions, in conjunction with enforcement of the new excise tax, would have several beneficial effects: to solidify judicial policy in an area where federal common law is just being created; to discourage employers from "pushing to the limit" their uses of pension funds for corporate purposes, while still encouraging creation and continuation of employee benefit plans; and finally, to best effectuate the purposes of ERISA.

\textbf{A. Proposal One—A Change in Judicial Policy}

One manner in which the courts might adjust judicial policy to reach an appropriate degree of stringency is to distinguish among plan surpluses by means of the circumstances surrounding the underlying terminations. Any termination executed for the employer's benefit which would harm, or could potentially harm the employees' interests in the plan would result in the denial of surplus reversion. If, for example, the court determines that a terminated plan has been or will likely be replaced by an inferior plan, reversion should be denied. However, terminations made because a particular

\textsuperscript{110} This is in contrast to any proposal which might \textit{limit} those situations in which reversion is possible.

\textsuperscript{111} Tax Reform Act of 1986, Pub. L. No 99-514, § 1132(a) (1986) (to be codified at 26 U.S.C. § 4980). This section contains several exceptions, however. No tax is imposed on excess funding due to mistake of law or fact, where the terminated plan is one maintained by a tax-exempt section 501(a) employer, or where the assets are transferred to an employee stock ownership plan (ESOP). See Prentice-Hall, A Complete Guide to the Tax Reform Act of 1986 1146-47 (1986).

\textsuperscript{112} For example, a $10,000 surplus minus the $1,000 tax leaves only $9,000 for recapture; whereas a $1,000,000 surplus minus the $100,000 tax still leaves a sizeable surplus: $900,000.
plan is not economically efficient, for example, would result in permissible reversion. This would necessarily entail a clarification of the meaning of "exclusive benefit" as used in ERISA section 1103(c)(1).\textsuperscript{113}

In order to implement this proposal effectively, the courts should make explicit and consistent distinctions between terminations under which reversions would or would not be permitted. By allowing surplus reversion only when the associated termination is in the employees' best interest, or at least causes them to suffer no detriment, the courts would effectuate both the spirit and the letter of ERISA.\textsuperscript{114}

**B. Proposal Two—Amend ERISA to Require Inflation Adjustments**

When Congress enacted ERISA, it recognized that the statute was not a comprehensive cure for the ills of the private pension system.\textsuperscript{115} After more than a decade of experience with ERISA, it is a proper time to consider amending the statute in areas in which it has proven deficient. Most of these areas fall outside the scope of this Note.\textsuperscript{116} One such area, however, which is closely related to the issue of pension plan surpluses concerns the adjustment of pension benefits for inflation.

Surplus reversion is often criticized by the private sector as being unjust in light of the inadequacy of retirees' fixed pension incomes due to inflation. Surpluses often accumulate because plan assets are yielding a higher return than anticipated. Increased asset yields and inflation often occur simultaneously. It is ironic that during periods of inflation reversion provides the greatest amount to the employer, while plan beneficiaries' defined benefits experience substantial losses of purchasing power. Retirees are commonly identified as one of the groups most severely affected by inflation because of the fixed nature of pension benefits.\textsuperscript{117}

\textsuperscript{113} See supra text accompanying notes 70-89.

\textsuperscript{114} Proposal One necessitates another decision. If reversion is denied, to whom is the surplus allocated? Three viable options arise: (1) the entire surplus could be returned to the employees; (2) only that portion of the surplus in excess of a "reasonable" amount would be divided among the participants; or (3) the PBGC could retain all or part of the surplus.

\textsuperscript{115} Congressman Biester made the following statement during the ERISA hearings:

> Although this measure is not a final answer to the problems of the private pension plan system, once it is enacted, and we have the opportunity to observe its impact over a period of time we will be in a position to evaluate its effects and then recommend whatever changes may be warranted.


\textsuperscript{116} For example, an area in which ERISA has proven deficient is the inequity which Congress perceived to exist with respect to qualified retirement plans for female employees and spouses of employees. Congress responded in 1984 with the passage of the Retirement Equity Act of 1984, Pub. L. 98-397, 98 Stat. 1426 (1984) (codified in scattered sections of 29 U.S.C.). A discussion of this and other remedial pension statutes is beyond the scope of this Note.

Opponents of surplus reversion point to the inequity of this phenomenon in light of the Deferred Wages Theory. It is unlikely that employees would rationally render services in return for future payment of today's deferred wages with knowledge that they would be receiving less real income than if they accepted their full wages when earned.

The courts, however, are quite reluctant to include inflationary considerations in contract law. To do so would create numerous additional dilemmas, such as whether to cite frustration, impossibility, or some other legal concept as a basis for remedial action and what remedies to employ.

ERISA also does not address the issue of the effects of inflation on pension benefits. Although some private plans include cost-of-living features which automatically adjust benefits for inflation, inclusion of such features is strictly optional under ERISA. Perhaps the most common method of benefit adjustment is the use of ad hoc benefit increases, but once again these increases are entirely within the discretion of the plan sponsor.

The problem of inflationary effects on pension benefits is one which seems to have received no satisfactory treatment by ERISA or the courts. Thus, the final proposal of this Note is that ERISA be amended to require some sort of cost-of-living adjustment or other indexation of benefits as a universal pension plan feature. Employers should be allowed the broadest possible discretion in selecting the type of provision to be included in their plans. Since ERISA was intended to assure an adequate standard of living for retired workers, such an amendment would strengthen the effect of the statute in this respect.

This proposal is germane to the surplus allocation problem because it is likely that mandatory inflation adjustment of pension benefits would significantly decrease the incidence of both shortages and surpluses upon termination. Indexation of pension benefits would cause benefits and asset values to fluctuate together. High benefits would accompany high asset values, thus eliminating surpluses. Depressed asset yields conversely would render lower plan benefits, thus eliminating a potential deficiency.

The major obstacles to effective implementation of the preceding proposal are: (1) the likely adverse reaction of employers, and (2) selection of the proper factor by which to index benefits. If these obstacles could be overcome, however, this proposal would improve the effectiveness of ERISA.

118. See supra text accompanying notes 16-17.
121. For a comprehensive description of this and other methods of benefit adjustment, see D. McGILL, supra note 28, at 192-96.
122. Possible suggestions include indexing to: the Consumer Price Index (CPI), a general wage index, or the minimum wage. See K. ROSENN, supra note 119, at 197.
in the area of providing retirement income security, while simultaneously alleviating to a substantial degree the courts’ dilemma over the proper allocation of huge surpluses.

CONCLUSION

The enactment of ERISA in 1974 provided a comprehensive body of statutory law to govern the complex area of private pension plans. Equally complex are the issues presented to the courts in the process of forming a corresponding body of federal common law. A prime example of this complexity is the issue of whether surplus pension assets should revert to the employer in the event of plan termination.

The survey of arguments for and against reversion indicates that a less extreme alternative than complete prohibition of reversion is desirable. One suggested policy change is to distinguish between terminations which in some way benefit the participants and those which strictly benefit the employer. Surpluses arising from terminations in the latter category would not revert.

A final proposal suggested in this Note involves an amendment to the Act itself rather than a change in judicial policy. An amendment to ERISA which would make inflation adjustment of plan benefits mandatory would increase post-retirement income security for beneficiaries, and might also reduce the overall incidence and size of both asset surpluses and shortages, depending on how benefits would be indexed. Although legislative amendment is a serious step, the proposal is worthy of consideration.

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