MORE ON UNDERFUNDED U.S. PENSION PLANS: WHAT IS A CANADIAN LENDER TO DO?

Smarter Way to Cross Blog Archives
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A recent blog entry by my colleague Ryan Murphy spoke of the risks to a Canadian company in acquiring a U.S. company with an underfunded defined benefit plan. But what about a Canadian lender that lends to a corporate group that includes an entity with a U.S. defined benefit plan—what risks does such a Canadian lender face and what should such a lender do?

The Risks for a Canadian Lender

A Canadian lender should be aware that a Canadian entity or any other entity that is a borrower or guarantor (a "loan party") may be liable under ERISA for the liabilities arising out of a U.S. defined benefit plan of an affiliate of such loan party, even though such loan party did not sponsor the plan or otherwise commit to assume such liabilities.

Though there is no specter of a deemed trust to protect the pension plan beneficiaries (as we understand there is in Canada), the Pension Benefit Guaranty Corporation (the PBGC) can file a lien on all assets of any loan party that is a member of the "controlled group" of companies to secure a missed contribution or contributions aggregating more than $1 million, or for any termination liability arising upon termination of an underfunded defined benefit plan. Such lien securing termination liability is limited to 30 percent of the collective net worth of the controlled group. In addition, excise taxes of up to 100 percent of the delinquent amount may become payable by a loan party for a missed contribution, and the failure to pay such excise taxes may result in the Internal Revenue Service (IRS) filing a notice of a tax lien. Any such lien filed by the PBGC or any lien for excise taxes may, after a short grace period, have priority over a lender's previously perfected security interest to the extent such security interest: a) attaches to assets acquired after the filing of a notice of a lien, or b) secures advances made by such lender after the filing of a notice of lien.

How does the PBGC or the IRS collect? What real risks are there that the assets of a Canadian or other non-U.S. loan party will become subject to claims of the PBGC or the IRS arising out of a U.S. affiliate's defined benefit plan? A U.S. judgment (assuming the PBGC can obtain jurisdiction in the United States over a loan party as further discussed in Ryan's blog entry) or a U.S. tax or ERISA lien against such a loan party can certainly be enforced against the assets of such loan party that are located or collectible in the United States. But what about the enforceability of such a judgment, or a U.S. tax or ERISA lien in a jurisdiction outside of the United States? Such enforcement will depend on the law of that jurisdiction (as modified by any treaty or agreement with the United States) and will likely be considerably more difficult. The threat of enforcement, however, may lead a loan party to settle. In any event, enforcement cannot be ruled out by the lender as a potential risk.

So What Should a Canadian Lender Do?

- Understand that certain pension liabilities of a U.S. entity in a corporate group may flow through to other entities, including Canadian entities, in the same group. These U.S. pension liabilities can't be isolated with a corporate wall.

- Include standard ERISA provisions in a loan agreement if any entity in the borrower's corporate group is a U.S. entity. These provisions are particularly important if any such entity contributes to a defined benefit pension plan.
- Retain knowledgeable U.S. counsel to search for U.S. tax liens and ERISA liens before closing. Asset-based lenders should also consider post-closing searches periodically (every 45 days), particularly if relying on U.S. assets of any loan party.
- Seek immediate advice from U.S. counsel if a U.S. tax lien or ERISA lien is filed against a loan party. Assuming the lender has the right to do so under the loan documents, the lender will need to consider: i) applying all collections on such loan party's receivables to the outstanding loan balance, and ii) immediately stopping all advances. One potential solution may be to obtain from the PBGC a subordination of its lien.