Simply Speaking

Obscure legal concepts or terms in a loan document explained in plain English

March 2020

ERISA

Example

ERISA Compliance

(a) Except as could not reasonably be expected, either individually or in the aggregate, to have a Material Adverse Effect, (i) each Plan is in compliance with the applicable provisions of ERISA, the Code and other federal or state Laws and (ii) each Plan that is intended to be a qualified plan under Section 401(a) of the Code has received a favorable determination letter from the IRS to the effect that the form of such Plan is qualified under Section 401(a) of the Code and the trust related thereto has been determined by the IRS to be exempt from federal income tax under Section 501(a) of the Code, or an application for such a letter is currently being processed by the IRS, and, to the knowledge of the Borrower, nothing has occurred that would be reasonably likely to cause the loss of such tax-qualified status.

(b) There are no pending or, to the knowledge of the Borrower, threatened or contemplated claims, actions or lawsuits, or action by any Governmental Authority, with respect to any Plan that, either individually or in the aggregate, could reasonably be expected to have a Material Adverse Effect. There has been no prohibited transaction or violation of the fiduciary responsibility rules with respect to any Plan that, either individually or in the aggregate, has had or could reasonably be expected to have a Material Adverse Effect.

(c) No ERISA Event has occurred, and neither the Borrower nor any ERISA Affiliate is aware of any fact, event or circumstance that, either individually or in the aggregate, could reasonably be expected to constitute or result in an ERISA Event, with respect to any Pension Plan that, either individually or in the aggregate, has had or could reasonably be expected to have a Material Adverse Effect.

(d) The present value of all accrued benefits under each Pension Plan (based on those assumptions used to fund such Pension Plan) did not, as of the last annual valuation date prior to the date on which this representation is made or deemed made, exceed the value of the assets of such Pension Plan allocable to such accrued benefits by a material amount. As of the most recent valuation date for each Multiemployer Plan, the potential liability of the Borrower or any ERISA Affiliate for a complete withdrawal from such Multiemployer Plan (within the meaning of Section 4203 or Section 4205 of ERISA), when aggregated with such potential liability for a complete withdrawal from all Multiemployer Plans, does not exceed a material amount.

(e) To the extent applicable, each Foreign Plan has been maintained in compliance with its terms and with the requirements of all applicable requirements of Law and has been maintained, where required, in good standing with applicable regulatory authorities, except to the extent that the failure so to comply could not reasonably be expected, either individually or in the aggregate, to have a Material Adverse Effect. Neither the Borrower nor any Subsidiary has incurred any material obligation in connection with the termination of or withdrawal from any Foreign Plan that has not been fully extinguished. The present value of the accrued benefit liabilities (whether or not vested) under each Foreign Plan that is funded, determined as of the end of the most recently ended fiscal year of the Borrower or Subsidiary, as applicable, on the basis of actuarial assumptions, each of which is reasonable, did not exceed the current value of the property of such Foreign Plan by a material amount, and for each Foreign Plan that is not funded, the obligations of such Foreign Plan are properly accrued in accordance with, and to the extent required under, applicable generally accepted accounting principles.

What is it and what does it do?

The Employee Retirement Income Security Act of 1974, as amended ("ERISA"), is a U.S. federal law that governs how employers provide benefits to their employees. ERISA imposes minimum standards on pension, health and other welfare benefit plans, on employers that maintain plans, and on fiduciaries managing plan assets.

Why is it there?

Lenders want assurances that the borrower is conducting its business in compliance with applicable law. Lending agreements typically contain borrower representations that each plan maintained by the borrower is in compliance with the applicable provisions of ERISA and that there are no pending or threatened claims, or lawsuits against its plans. These representations are often qualified by a Material Adverse Effect provision.

Unless the borrower or any member of the borrower's "controlled group" (an "ERISA Affiliate") has maintained a defined benefit pension plan subject to ERISA or contributed to a union pension plan subject to ERISA, the ERISA representations are typically not problematic for a borrower. If the borrower or a member of the borrower's controlled group has maintained a defined benefit pension plan or contributed to a union plan, several complications can arise. A failure by the employer or ERISA Affiliates to meet the funding standards prescribed by ERISA for these types of pension plans can give rise to the imposition of liens or other rights against the assets of any member of the controlled group, which may impair the lender's rights to exercise remedies against those assets.

Why is it important (or not so important) to a lender?

In a secured financing, the lender has recourse against the assets of the borrower as collateral. It is important to ensure, from the lender's perspective, that no other person has superior rights against those assets, lest the lender not be able to realize the full value of the collateral. Under ERISA, the Pension Benefit Guaranty Corporation ("PBGC") can make a claim on an employer's assets to meet the benefit obligations of its defined benefit pension plan, a union plan can demand the payment for an employer's share of underfunding upon withdrawal from the plan, and these liabilities can be applied to any member of the borrower's controlled group. These pension liabilities could supersede the liens granted to the lender by a contract, and interfere with the lender's rights to the collateral.

How does it affect the borrower in practical terms?

Borrowers that sponsor defined benefit pension plan should be prepared to make representations as to the plan's funding status. Borrowers that contribute to union plans should be prepared to make representations as to the extent of their potential withdrawal liability.

Importantly, the ERISA provisions typically cover plans of the borrower's subsidiaries and other members of its "controlled group" (which may, for example, include parent and brother-sister entities, individuals and trusts with significant ownership, and management entities), so even if the borrower does not offer a defined benefit plan or contribute to a union plan, it may need to consider whether the ERISA provisions are relevant as a result of plans of ERISA Affiliates or any other parties picked up in the ERISA provisions (e.g., a guarantor and, possibly, the guarantor's ERISA Affiliates).

What types of plans are typically considered for purposes of these provisions?

Typically, the relevant types of defined benefit or union plans include U.S. defined benefit pension plans, union or "multiemployer" plans, and "money purchase plans". These plans are subject to a set of particular rules and requirements and are subject to supervision by the PBGC, which insures pension benefits. These are commonly referred to as "Title IV" plans, since that is the section of ERISA that regulates the PBGC and these types of plans. Typical 401(k) plans, "defined contribution" profit sharing retirement plans, and welfare plans are not usually covered by these provisions, since the PBGC lien issue does not exist for those types of plans.

Are "foreign plans" relevant?

It has become increasingly common for a credit agreement's ERISA provisions to address certain non-U.S. plans as well. Typically, the types of foreign plans that are covered in the loan agreement's "ERISA" provisions include foreign retirement plans and arrangements, as well as deferred compensation and severance plans and arrangements that defer benefit payments until termination of employment or retirement. The "controlled group" concept, however, generally is not applicable in the foreign plan context, so it is typically a narrower group of entities that is relevant in this regard (e.g., the borrower and its subsidiaries, or possibly a guarantor and its subsidiaries as well). Accordingly, a borrower may need to consider whether there are any applicable foreign plans, and, if so, whether the foreign plan provisions present any issues in their terms and application.

How is it relevant to shipping?

In the context of a typical ship finance structure, where a special purpose vehicle is set up to own a vessel, which then is mortgaged for the benefit of a lender making a loan available, often the Borrower will not have U.S. plans. However, a borrower will still need to consider what other entities may be in its “controlled group”, and determine whether any of those ERISA Affiliates may have, or had in the recent past, any plans that cause any concerns under the ERISA provisions. Typically, the biggest consideration in that case is whether any “controlled group” member has or had any covered pension plans and, if so, whether there would be any issues in that regard with respect to the ERISA provisions. For example, if there are any covered pension plans in the “controlled group”, a borrower would need to consider if the funding status representations are accurate, or whether there were any “ERISA Events” (e.g., a plan termination, a request for a funding waiver, a failure to satisfy annual plan contribution requirements) in the recent past.

How is it negotiated?

Where there are no covered pension plans, and none have existed in the recent past nor are any anticipated to exist during the term of the credit facility, the ERISA provisions could be simplified by including a representation and a covenant that no such plan exists, has existed in the recent past, or will exist in the future. In the event there actually is, was, or may likely in the future be a covered plan in question, more fulsome ERISA provisions would be included. A lender’s market standard form language is often accepted by the borrower; however, there may be a need for a lender to understand, and/or for the parties to reflect in the agreement, underfunding levels for DB plans, if they apply. Likewise, similar considerations may apply in respect of foreign plans.

Questions?

Please contact any member of S&K's ERISA and Maritime Practice Team.

Lawrence Rutkowski
+1.212.574.1206
rutkowski@sewkis.com

Mike Timpone
+1.212.574.1342
timpone@sewkis.com

Hoyoon Nam
+1.212.574.1640
nam@sewkis.com

S. John Ryan
+1.212.574.1679
ryans@sewkis.com

Michael O'Brien
+1.212.574.1505
obrienm@sewkis.com

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