Multiemployer Pension Plan Withdrawal Liability

Judith F. Mazo and Susan Lee

After a decade of volatile investment returns that has left many retirement plans with diminished assets, withdrawal liability has reemerged as an important consideration for multiemployer plan trustees, the sponsoring unions and employers, and the plans' professional advisors. This article reviews the basic principles of employer withdrawal liability, which was the most visible and controversial feature of the Multiemployer Pension Plan Amendments Act of 1980 (MPPAA). As on all matters of legal interpretation and application, parties should rely on their attorneys for authoritative advice on how the withdrawal liability provisions of MPPAA affect them.

The Multiemployer Pension Plan Amendments Act of 1980 (MPPAA), which became law on September 26, 1980, changed the federal termination insurance program for multiemployer pension plans into one in which the employers guarantee plan funding, through payments that become due when they stop contributing. The Pension Benefit Guaranty Corporation (PBGC) took on a backup role, stepping in to support benefit payments only when all other resources are exhausted.

In the years since MPPAA's enactment, the US Supreme Court has considered and affirmed the constitutionality of withdrawal liability on several occasions.

The Pension Protection Act of 2006 (PPA 2006) made a few technical changes to the withdrawal liability rules. Those changes are discussed in the relevant section below. In general, the withdrawal liability rules remain largely unchanged since 1980.

Judith F. Mazo, JD, is Senior Vice President, Director of Research, The Segal Company, Washington, DC. Ms. Mazo is responsible for directing research and providing guidance on public policy, legislative and regulatory issues, and other matters of interest to Segal clients. She serves on Segal's Senior Management Team. Susan Lee, ASA, MAAA, FCA, EA, is Senior Vice President, Actuary, Co-Manager of New York Actuarial Department, The Segal Company, New York, New York. Ms. Lee has more than 35 years of experience in working with multiemployer defined benefit retirement plans. She is a member of Segal's Actuarial Manager's Committee, which is responsible for developing the policies pertaining to all actuarial work performed by the firm and is currently the Enrolled Actuary for approximately 30 multiemployer plans. Ms. Lee has served on the Pension Committee of the Actuarial Standards Board.

EMPLOYER WITHDRAWAL LIABILITY

Under the withdrawal liability rules, an employer that withdraws from a multiemployer plan must continue payments to the plan to help complete funding the plan's liability for vested benefits. In general, "withdrawal" means the employer has permanently ceased operations under the plan or has permanently ceased to have an obligation to contribute.

Special Rules

MPPAA established special withdrawal liability rules for some industries:

1. Construction;
2. Entertainment; and
3. Trucking, moving, and warehousing.

Special Rule for the Construction Industry

There is a special definition of "withdrawal" for the construction industry. Cessation of contributions is not by itself considered a withdrawal. Withdrawal liability is incurred only if the employer is no longer obligated to contribute, but continues (or within five years resumes) the same type of work in the same area as was covered by the union agreement and does not contribute on that work.[1]

In other words, a construction contractor that decides to retire, close down, or sell its business does not face withdrawal liability. That will be owed only by contractors that stay in business but end their relationship with the multiemployer plan.

Special Rule for the Entertainment Industry

For entertainment industry plans (*e.g.*, stage, screen, radio, television, and musicians) there is a similar rule for employers that contribute to a particular plan primarily for work of a temporary or project-by-project nature: "withdrawal" occurs if the employer continues (or within five years resumes) the type of work covered by the plan without contributing.[2]

Special Rule for the Trucking, Moving, and Warehousing Industry

If "substantially all" of a plan's coverage is in the trucking, public warehousing, or household goods moving industry, withdrawal by an employer primarily in such industry involves liability only if:

1. The employer continues to do work within the jurisdiction of the plan; or

2. Its withdrawal does "substantial damage" to the plan's contribution base.

The PBGC will determine "substantial damage," taking account of that and other discontinuances over the ensuing five years. Pending that determination, the employer must post a bond or security for half the amount of its potential liability. In practice, the special trucking industry rule has had little application, either because the plans where it was invoked cover work in industries beyond trucking and freight-hauling or because the withdrawn employers were engaged in a broader range of operations.

Extension of the Special Rules

The PBGC is authorized to extend, by regulation, rules similar to those for construction and entertainment to other industries with the same characteristics. Rather than doing so across the board, it has approved the adoption of comparable rules by individual plans, including plans covering local school bus drivers, longshore workers, and janitors in office buildings.

Free-Look Option

A special provision in MPPAA permits a plan meeting certain requirements to allow a new employer to come into the plan for up to five years with no potential for withdrawal liability.[3] The plan must have assets at least eight times the amount of its annual benefit payments when the employer joins, and it must provide for the cancellation of past service benefits if the employer discontinues. The provision is not available to an employer that would account for 2 percent or more of total contributions to the plan. Before PPA 2006, plans that primarily covered employees in the building and construction industry were not permitted to adopt this free-look option. PPA 2006 eliminated that exclusion, allowing plans in the construction industry to offer the free look to new employers.

WITHDRAWAL LIABILITY AND CORPORATE TRANSACTIONS

Sale of Assets and Limitation of Liability

If an employer ceases all or some of its covered activity in connection with a sale of assets, that can be considered a withdrawal or partial withdrawal (except in the construction and entertainment industries). However, the seller can avoid incurring liability if the purchaser takes over the obligation to contribute for a base of substantially the same size.

Section 4204 of the Employee Retirement Income Security Act (ERISA) lays out the blueprint for avoiding a withdrawal in this kind of transaction. The purchaser must put up a bond or escrow for five years in an amount equal to a year's contributions, to cover the contributions required by the union contract. In addition, the seller has secondary liability if the purchaser withdraws from the plan within five years after the sale and fails to pay its withdrawal liability. (The sales contract must so state.) The seller must post security for its contingent secondary liability if it liquidates or distributes its remaining assets in the five years after the sale.

The PBGC has eliminated the need for a bond or escrow in any case in which:

1. The buyer's net income for each of the previous three years was at least 150 percent of the security that would be required; or

2. Its net tangible assets were worth at least as much as the amount that would have to be posted in a bond or escrow.

Either the PBGC or the plan's board of trustees can grant individual waivers beyond that if doing so would not significantly increase the plan's risk of financial loss.

A buyer that assumes the seller's contribution obligation through a transaction that comes within ERISA Section 4204 inherits five years of the seller's contribution history, for purposes of allocating potential withdrawal liability.

ERISA Section 4204 enables sellers to avoid incurring withdrawal liability. Whether or not it is used, there is a prescribed limit to the liability of an employer that has sold all or substantially all of its assets: It is a percentage of the employer's liquidation or dissolution value. This ranges from 30 percent for the first $5 million to 80 percent on the portion of the value that is more than $25 million. This provision does not, however, limit the liability based on the unfunded vested benefits attributable to service with the employer.

Other Circumstances

The following other circumstances may affect an employer's withdrawal liability:

- Business reorganization;

- Insolvency liquidations; and

- Personal assets.

Business Reorganization

A change in an employer's identity because of a merger, spin-off, or change in business structure is not a withdrawal, if the obligation to contribute continues.

Insolvency Liquidations

If an employer is insolvent and undergoing liquidation or dissolution when it withdraws, one half of the withdrawal liability is contingent on whether there is sufficient liquidation or dissolution value to pay it, after the employer's other debts have been paid.

Personal Assets

In the case of a sole proprietor or partner, the individual's personal assets are exempt from liability to the same extent as under the bankruptcy laws.

DETERMINING THE AMOUNT OF WITHDRAWAL LIABILITY

When an employer withdraws, the plan's trustees must determine the amount of the employer's withdrawal liability. This is based essentially on the extent of the plan's unfunded, vested benefits as of the end of the plan year preceding the withdrawal.[4] Employers have the right to receive a liability estimate from the plan, based on a withdrawal in the preceding year, along with an explanation of how it was determined and the data inputs used. A plan can charge employers for the cost of furnishing the information.

Measuring Unfunded Vested Benefits

Withdrawal liability is based on the value of the plan's unfunded vested benefits, as determined by the plan's enrolled actuary. Two main methodologies for calculating that value have emerged over the years. The "Segal Blended Method," developed by The Segal Company and used by its actuaries and others, uses a blend of insurance company annuity close-out rates (as reflected in the official interest assumptions used by the PBGC) and plan funding assumptions. Other actuaries tend to use the same actuarial assumptions and methods that they use for ongoing plan funding. Both approaches have been upheld as reasonable.

Allocating Liability Among Employers

A specific statutory formula—often referred to as the "presumptive rule"—assigns a share of that unfunded liability to the employer that has withdrawn. The law also provides several alternative formulas that a plan may choose by amendment; in the absence of such an amendment, the statutory formula is applicable.

A construction industry plan is limited to the statutory formula for its construction industry contributors. If it also has nonconstruction employers, it may adopt a different formula for them, subject to PBGC approval.

The statutory formula distinguishes among the employers based on when they started participating. Each employer is assigned a pro rata share of the plan's unfunded vested liabilities that developed while that employer was obligated to contribute. That way, new employers can be assured that, in general, they are not going to be asked to pay for inherited benefits that the plan owed before the employers joined.

Each year the change in the plan's unfunded vested liabilities—up or down—is allocated among the employers that were required to contribute that year, based on what they were obligated to pay in over the preceding five years. In addition, if the trustees determine that that liability previously assessed to withdrawn employers has become uncollectible in a year, it is allocated among that year's contributing employers in the same manner. If at some point an employer withdraws, the amount of its liability is the sum of what remains of the annual allocations. Each portion is reduced to the point of withdrawal by 5 percent each year.

Special Calculation Adjustments for "Red-Zone" Plans

PPA 2006 allows multiemployer plans that go into critical status (the "red zone") to reduce certain benefits that would otherwise be considered vested. However, a special rule provides that withdrawal liability is to be determined without taking those benefit reductions into account. In addition, the surcharges charged to employers when a plan goes into the red zone are to be ignored in allocating withdrawal liability among the employers.

Annual Payments

An employer that withdraws is required to pay its liability in annual amounts based on its contributions in the preceding ten years. More specifically, the annual amount is the highest contribution rate in the ten years including the year of the withdrawal multiplied by the employer's average contribution base (*e.g.*, covered hours or days) in the three years (of the ten ending with the last plan year before withdrawal) in which the base was greatest. The total amount due for a year is payable in quarterly or monthly installments, as specified by the plan. These payments are continued until the employer's withdrawal liability is entirely paid up, but for no more than 20 years. These annual payments are counted as employer contributions, for funding and deduction purposes.

Alternative Allocation Rules

Multiemployer plans (except for construction industry plans) may choose other rules for determining the employer's withdrawal liability:

- One pool of unfunded vested liability; and
- Attributable liabilities.

One Pool of Unfunded Vested Liability

Any employer that withdraws will share in the plan's unfunded vested liability in the ratio of the employer's contributions to the total contributions in the five years preceding withdrawal. There is no distinction between recent and long-standing contributors.

Attributable Liabilities

Generally designed for industries with stable employment, this rule holds a withdrawing employer liable for completing the funding of the vested benefits of its own employees and retirees (that is, the benefits that were earned in the service of that employer). Each employer would also be responsible for a share of any "unattributable liability," that is, unfunded vested benefits that cannot be assigned to any of the contributing employers, such as benefits accrued by service with employers that left the plan without paying full withdrawal liability.

Approval

The PBGC has granted blanket approval for any plan (other than one primarily in the construction industry) to adopt either of the two specified statutory alternatives to the presumptive allocation rule, without individual review by the PBGC.[5]

Because some other formula may be more suitable in a particular case, the law authorizes any other method of allocation proposed by a plan and accepted by the PBGC. The PBGC will only approve alternative allocation methods if:

1. They are based either on benefits attributable to the employer or on its contribution history; and
2. They allocate substantially all of the plan's liabilities among the current contributors, to the same extent as the statutory methods.

PBGC regulations lay out the procedures and requirements for seeking approval of an individually tailored alternative. All contributing employers must be informed of the adoption of any alternative liability allocation rule that a plan adopts, and no such alternative rule can be applied to any withdrawal that occurs before the alternative was adopted, unless the employer consents.

"Fresh Start"

ERISA, as amended by PPA 2006, allows all plans to get a "fresh start" by restarting their withdrawal liability calculations as of a year in which the plan had no unfunded vested benefits. The PBGC may also allow a fresh start for nonconstruction plans that are not fully funded.

PLAN MERGERS

The law provides that, for withdrawals that occur in the first year after a merger of multiemployer plans, liability is determined as if the plans were still separate. PBGC regulations explain how the plans' asset, liability, and contribution histories are determined for later years, basically by phasing out the old liability pools and moving over time to a single, blended pool. The regulations also authorize plans to start fresh with one pool combining assets and liabilities from all of the merging plans, to simplify the recordkeeping and allocation process going forward. In addition, some plans outside of the construction industry have designed their own approaches, subject to PBGC approval, which follow principles agreed to by the merger partners before the transaction.

DEDUCTIBLE/*DE MINIMIS*

The law requires that small amounts of withdrawal liability be overlooked:

- Liability is to be reduced by a deductible of $50,000 (or, if less, three quarters of one percent of the plan's unfunded vested liability);[6]
- However, this deductible begins to "vanish" as the initial liability amount exceeds $100,000. It is reduced by $1 for each $1 of the excess. Consequently an initial liability allocation of $150,000 is not subject to any deductible; and
- A plan may, by amendment, substitute for the $50,000 a deductible of up to $100,000 (but in no event more than the three quarters of one percent of the plan's unfunded vested liability). In that case, the point at which the deductible starts to shrink changes from $100,000 to $150,000. Consequently,

at its furthest reach, a liberalized deductible will not affect an initial liability amount of $250,000 or more.

Beyond this statutory *de minimis* rule, plan trustees have the authority and responsibility, as fiduciaries, to make a prudent judgment about how much to spend to collect withdrawal liability that has been assessed against a given employer in light of the amount likely to be recovered on behalf of the plan.

PARTIAL WITHDRAWAL

An employer may also be liable because of a "partial withdrawal." Any one of the following can trigger a partial withdrawal:

- Severe shrinkage;
- A bargaining agreement take-out; and
- A facility take-out.

Severe Shrinkage

The employer's contribution base (generally, employment covered by the plan) has decreased by at least 70 percent, and stayed at that depressed level for an extended period. This is to be measured by comparing the base in each of the last three consecutive years with the average base in the two highest years within the five years before that three-year period.

A Bargaining Agreement Take-Out

The employer ceases to be obligated to contribute for a group covered by a separate bargaining agreement, although work that had been covered continues.

A Facility Take-Out

The employer ceases to be obligated to contribute for a facility, although work that had been covered continues at the facility. Under PPA 2006, an employer may also be liable for a partial withdrawal if it transfers work to another location or related entity.

Fluctuations in Employers' Contribution History

The liability for partial withdrawal is a prorated part of the liability for complete withdrawal.

To identify partial withdrawals that may occur in 2010 or later years, plans will need to review data on fluctuations in employers' contribution history going as far as eight years back.

Special Rules

There are special partial withdrawal rules for certain industries:

- Construction industry;
- Entertainment industry;
- Retail food industry; and
- Bituminous coal miners fund.

Construction Industry

There is no partial withdrawal, unless the employer continues under the plan for only an "insubstantial" portion of its total work in the jurisdiction. This is explained as intended to deal with an employer that has shifted its work-mix in the jurisdiction so that only an insubstantial portion is left covered by the plan. An example would be a contractor that went non-union for most of its work in the area, but kept one or two workers under the contract calling for plan contributions.

Entertainment Industry

In general, there is no partial withdrawal liability for employers covered by the special entertainment industry rule. The PBGC can prescribe partial withdrawal rules for this industry, but it has not done so.

Retail Food Industry

The plan may define the shrinkage test as a 35 percent, instead of 70 percent, reduction.

Bituminous Coal Miners Fund

The plan may define other conditions of partial withdrawal.

"EMPLOYER" DEFINED

For withdrawal liability, as for other purposes under the termination insurance provisions of ERISA, the term "employer" includes all corporations, trades, or businesses under common control. "Common control," in turn, has a specific, technical meaning that is further spelled out in PBGC and Internal Revenue Service (IRS) regulations. Because of this controlled group concept, if several companies that are under common ownership contribute to the same multiemployer plan, and when one of them stops contributing, that may not be a withdrawal if the others are keeping substantial operations under the plan. On the other hand, if one member of a controlled group does withdraw and incur withdrawal liability, the whole group is obliged to pay it.

REVIEW OF LIABILITY ASSESSMENT

Disputes between a plan and an employer over a withdrawal liability determination must go to arbitration. The determination by the plan's trustees is presumed to be correct unless the employer shows, by a preponderance of the evidence, that it is unreasonable or clearly erroneous. The decision of the arbitrator is subject to limited court review, and is presumed correct as to his or her findings of fact, rebuttable only by a clear preponderance of the evidence.

While a withdrawal liability determination is being disputed, the withdrawn employer must make the scheduled payments to the plan. They will be refunded with interest if the employer prevails.

PPA 2006 introduced a requirement that plan collection safeguards be revised in the case of a determination by the plan of a complete or partial withdrawal based on a finding of intent of a transaction to evade or avoid withdrawal liability.

ABATEMENT OF WITHDRAWAL LIABILITY

An employer's withdrawal liability is to be abated, in accordance with PBGC regulations if it resumes participation in the plan. If the liability was for partial withdrawal based on severe shrinkage, MPPAA includes formulas for abatement of liability if the employer's contribution base later increases.

ACCOUNTING TREATMENT

Unlike the expense, net assets, or net liabilities attributable to single employer pension plans that they sponsor, employers are not required to reflect potential multiemployer-plan withdrawal liability in their financial statements. Instead, the accounting profession only requires withdrawal liability to be recorded as an employer obligation when the employer has withdrawn or withdrawal is imminent.

PLAN TERMINATION—MASS WITHDRAWAL

In connection with the imposition of withdrawal liability, MPPAA redefined the concept of "termination" for multiemployer plans. Instead of turning the plan over to the PBGC or immediately cashing out all benefits, termination of a multiemployer plan is accomplished by amending it to "freeze" a plan by ceasing the accrual of benefits *and any further vesting*. The plan continues, however, for the purpose of paying out the frozen benefits, and employers remain obligated to contribute at rates sufficient to fund the terminated plan. Instead of imposing a dollar liability on each employer, the law requires contributions to continue at negotiated rates, sufficient to meet the funding requirements.

Termination can also occur through a mass withdrawal, which would happen if there were no agreements to contribute. In that case, each employer would have a withdrawal liability, which would be paid in annual dollar amounts.

If there is mass withdrawal, special provisions make sure that the liability of all the employers will add up to the plan's total unfunded liability for vested benefits. Limitations of liability such as the deductible reduction and the 20-year limit on liability payments are not then applicable, and certain unpaid withdrawal liability amounts are reallocated to other employers. It is presumed to be a mass withdrawal if substantially all the employers withdraw within three years.

NEXT STEPS

With the reemergence of withdrawal liability, trustees will be addressing numerous policy issues, some for the first time. In addition, fund administrators will need to gear up for the challenge of identifying withdrawals and assessing and collecting liability efficiently and fairly. This will include identifying employers, tracking contribution histories, and monitoring contribution fluctuations to determine whether and when there has been a permanent cessation. Billing, appeal, and liability arbitration rules and procedures may also need to be put in place.

Multiemployer plans now facing withdrawal liability may also want to communicate affirmatively with their contributing employers and the unions that represent their participants, to allay undue fears and help all parties avoid disruptive surprises. Obviously, each plan's legal counsel will need to play a major role in the design and implementation of these activities.

NOTES

1. If the plan is not predominantly construction, it may adopt the "construction rule" for its construction employers. On the other hand, some predominantly construction funds include employers that are not in the construction industry (*e.g.*, fabricators and manufacturers).

2. While the PBGC is authorized to exclude specific classes of employers from the application of this special rule, to date it has not done so.

3. Officially, the free-look period is for the lower of six years or the number of years required for vesting. Since enactment of this provision, the maximum period multiemployer plans require for vesting has dropped to five years.

4. However, under the basic rules for assigning withdrawal liability an individual employer could have some allocated liability even if the plan's assets, in total, cover all of its vested benefits as of the last valuation date.

5. Another alternative laid out in the law, the "two-pool method," has become obsolete with the passage of time.

6. The full $50,000 deductible applies to plans that have an unfunded vested liability of more than $6.7 million.