Multi-Employer Pension Plan Withdrawal Liability: Buyer Beware

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OVERVIEW OF WITHDRAWAL LIABILITY

The Multi-employer Pension Plan Amendment Act of 1980 **("MPPAA")** amended the Employee Retirement Income Security Act of 1974 ("ERISA"), to impose liability for a share of the **unfunded vested benefits ("UVB")** of multi-employer defined benefit pension plans on employers who withdraw from such plans. MPPAA was amended by the Pension Protection Act of 2006 **("PPA")** and the Multiemployer Pension Reform Act of 2014 **("MPRA")**.

Under MPPAA when an employer withdraws from a multi-employer defined benefit pension plan which has UVBs, the employer is generally liable to the pension plan for a share of the unfunded vested benefits in an amount determined under MPPAA.

PPA modified the funding provisions of ERISA for pension plans, including provisions to shore up ailing defined benefit pension plans.

PPA creates three status groups for funds:

- funds which meet the funding standards and have a funding percentage of >80% (**Green Zone**);
- "endangered" or "seriously endangered" funds (**Yellow Zone**); and
- "critical" or "critical and declining" funds (**Red Zone**).

The fund's actuary must certify the fund's status within 90 days of the start of each plan year.

Endangered Status (Yellow Zone). A fund is in endangered status if it either: **(a) has a funding percentage of 80% or less** or **(b) faces a funding deficiency within the next 6 years**. A fund is in **seriously endangered** status if it satisfies both conditions.

- The fund must **adopt a funding improvement plan** to increase its funding over 10 years (15 if seriously endangered).

- The fund must provide the bargaining parties with two schedules to pick from for the next CBA:
  - One to maintain the current contributions but reduce benefits (the default schedule).
  - One to maintain benefits and increase contributions.
  - If the parties don't select a schedule within 180 days after the contract expires (or upon impasse) the fund must implement the default schedule.
- Generally, there can be no plan changes or benefit increases that increase the pension fund's benefit obligations.

- The fund cannot accept a CBA or participation agreement that provides for:
  - a reduction in the level of contributions for any participants;
  - a suspension of contributions with respect to any period of service, or
  - any new direct or indirect exclusion of younger or newly hired employees from plan participation.

Critical Status (Red Zone). A funding percentage of 65% or less or **projected to have a funding deficiency or cash-flow crisis within 3 to 6 years**. The effects are the same as being endangered, plus:

- Fund must adopt a **"rehabilitation" plan** to emerge from critical status in 10 years. Additional Employer Contributions are **Rehab Plan Increases**.
- Within 30 days of receiving notice from the fund, the employer must pay a 5% **"PPA Surcharge"** on contributions (10% after the initial year) until the effective date of a CBA in which the parties adopt one of the fund's contribution schedules.

- Prospective benefit reductions are permitted for "adjustable benefits", such as full early retirement, post-retirement death benefits, disability benefits not in pay status, or 60-month guarantees.
- Future benefit accrual rates can be reduced, but not to less than 1% of contributions.

Questions to ask in a merger or acquisition:

- Is there a collective bargaining agreement?
- Does the employer contribute to a pension plan on behalf of union employees?
- Is the pension plan a multi-employer plan or a single employer plan?
- If it is a multi-employer plan, is it a defined benefit plan or a defined contribution plan?
- If the plan is a multi-employer defined benefit plan, is it underfunded and is there a withdrawal liability?

- If there is a withdrawal liability:
  - A sale of assets may trigger withdrawal liability for the seller.
  - A purchase of stock may result in an assumption of the potential withdrawal liability as a contingent liability of the buyer.
  - A purchase of assets may also result in assumption of the potential withdrawal liability by the buyer.

DETERMINATION OF WHETHER A WITHDRAWAL HAS OCCURRED

Complete Withdrawal. ERISA §4203(a).

A complete withdrawal from a multi-employer plan occurs when an employer:

- Permanently ceases to have an obligation to contribute under the plan; or
- Permanently ceases all covered operations under the plan.

The date of a complete withdrawal is the date of the cessation of the obligation to contribute or the cessation of covered operations.

Partial Withdrawal. ERISA §4205.

A partial withdrawal from a multi-employer plan occurs on the last day of a plan year in which there is either (1) a seventy percent decline in contribution base units; or (2) a partial cessation of the employer's contribution obligation.

- **Seventy percent contribution decline.** ERISA §4205(a)(1).

  A seventy percent decline in contribution base units occurs if, during the plan year and each of the preceding two plan years (the **three-year testing period**), the number of **contribution base units or "CBUs"** (the units upon which contributions to the plan are based, such as "hours worked" or "weeks worked") for which the employer was required to make plan contributions **did not exceed thirty percent** of the number of contribution base units for the "high base year." The **"high base year"** is determined by averaging the employer's contribution base units for the two plan years for which such units were the highest within the five plan years preceding the three year testing period.

- **Partial cessation of an employer's contribution obligation.** ERISA §4205(a)(2). A partial cessation occurs in either of the following situations:

  - A **"bargaining unit take-out."** ERISA §4205(b)(2)(A)(i).

    An employer who is required to contribute to a plan under two or more collective bargaining agreements ceases to have an obligation to contribute under at least one but not all of the agreements, but continues work in the jurisdiction of the agreement of the type for which contributions were previously required or transfers such work to another location.

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  - **A "facility take-out."** ERISA §4205(b)(2)(A)(ii).

    An employer permanently ceases to have an obligation to contribute under the plan for work performed at one or more but fewer than all of its facilities covered under the plan, but continues to perform work at the facility of the type for which the obligation to contribute ceases.

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Special Rules for Construction Industry. ERISA §4203(b).

The construction industry is afforded a partial exemption from the employer withdrawal liability rules. Generally, a construction industry employer will be permitted to withdraw from a plan without incurring any liability, unless it continues to perform work in the covered area of the sort performed by the covered employees.

For plans and employers that qualify for the construction industry exception, a complete withdrawal occurs only if the employer ceases to have an obligation to contribute to the plan, and, in addition, either (a) continues to perform the same or similar work (*i.e.*, work of the type for which contributions were previously required) in the jurisdiction of the collective bargaining agreement; or (b) resumes such work within five years after the cessation of the obligation to contribute, and does not renew the obligation at the time of the resumption.

Mass Withdrawal Liability.

- A multi-employer pension plan can terminate due to the "mass withdrawal" of all contributing employers. 29 U.S.C. §1341a(a)(2). A "mass withdrawal" means:
  - the withdrawal of every employer from the plan,
  - the cessation of the obligation of all employers to contribute under the plan, or
  - the withdrawal of substantially all employers pursuant to an agreement or arrangement to withdraw.

- Employers involved in a mass withdrawal not only have to pay the "initial" withdrawal liability as outlined below, but **also must pay the amounts which would otherwise be excluded under the *de minimis* and 20-year limitation provisions**. 29 U.S.C. §§1389(c), 1399(c)(1)(D); 29 C.F.R. §§4219.11, 4219.12.

- ***Employers who withdraw within three years of a mass withdrawal*** are presumed to have withdrawn pursuant to an agreement or arrangement to withdraw and ***may be liable for reallocation liability***. This presumption may be rebutted by a preponderance of the evidence. 29 U.S.C. §§1389(d), 1399(c)(1)(D); 29 C.F.R. §4219.12(g). Reallocation liability is an amount of UVBs which are not otherwise collected or collectible by the pension plan, such as amounts uncollectible due to the bankruptcy of employers.

CALCULATION OF WITHDRAWAL LIABILITY

Methods for Computing Withdrawal Liability. ERISA §4211.

MPPAA established a **"presumptive method"** for computing and allocating withdrawal liability. ERISA also provides several alternative methods upon which plans may compute withdrawal liability. However, the presumptive method will generally apply unless a plan specifically adopts one of the alternative methods.

An individual employer's percentage share of the plan's total UVBs is basically equivalent to the ratio between the employer's contributions to the plan and the total contributions made to the plan by all employers for the same period. For example, an employer who contributes one percent of the total contributions made to the plan will have a withdrawal liability equal to approximately one percent of the plan's UVBs.

A plan may calculate an employer's withdrawal liability percentage based on the employer's contributions to the plan over a **specific period such as the 5 or 10 year period prior to the withdrawal**.

PRACTICE NOTE:

Employer Contributions based on:

1. **Rehab Plan Increases**; or
2. **PPA Surcharges**

are **not included for** purposes of determining either:

- **Withdrawal Liability**; or
- **Withdrawal Liability Payments**.

Board of Trustees, IBT Local 863 Pension Fund v. C&S Wholesale Grocers, 802 F.3d 534 (3d Cir. 2015).

Reduction Under the ***de Minimis* Rule**. ERISA §4209.

An employer's withdrawal liability will be reduced by the lesser of (1) $50,000; or (2) three-fourths of one percent of the plan's unfunded vested benefits determined as of the end of the most recent plan year ending before the date of withdrawal. The amount offset under the *de minimis* rule is reduced, dollar-for-dollar, as an employer's withdrawal liability, determined without regard to the *de minimis* rule, exceeds $100,000. Therefore, the exemption under the *de minimis* rule is only applicable when an employer's withdrawal liability is less than $150,000.

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De Minimis Rule: Examples

- Withdrawal liability of $45,000 would be reduced to $0;
- Withdrawal liability of $75,000 would be reduced by $50,000 and final liability would be $25,000;
- Withdrawal liability of $110,000 would be reduced by $40,000 and final liability would be $70,000; and
- Withdrawal liability of $150,000 would not be reduced at all.

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DETERMINATION OF WITHDRAWAL LIABILITY PAYMENTS.

ERISA §4219(c)(1)(C).

The payment schedule under which the withdrawing employer is required to pay its withdrawal liability is determined by the plan sponsor pursuant to a specific formula.

Annual amount of withdrawal liability payment equals

Average annual number of contribution base units (*e.g.*, hours worked or weeks worked) for the three consecutive plan years during the ten consecutive plan year period ending before the plan year in which the withdrawal occurs in which the number of contribution base units for which the employer had an obligation to contribute under the plan were the highest.

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Highest contribution rate (*e.g.*, dollars per hour or dollars per week) at which the employer had an obligation to contribute under the plan during the ten plan years ending with the plan year in which the withdrawal occurs.

The amount determined under this formula is the level annual payment which is to be paid over a period of years necessary to amortize the liability, subject to the twenty-year payment cap discussed below.

Length of Payments: **Twenty-Year Payment Cap.** ERISA §4219(c)(1)(B).

The employer is required to make level annual payments to the pension plan for the lesser of (1) the number of years it would take to amortize its withdrawal liability (determined under the actuarial and interest assumptions used in the most recent actuarial valuation of the plan); or (2) twenty years.

The twenty-year payment cap **does not apply** if a multi-employer pension plan terminates due to a Mass Employer Withdrawal. In such a case, the total UVBs of the plan are allocated to all employers.

Prepayment of Withdrawal Liability. ERISA §4219(c)(4).

The employer is entitled to prepay the outstanding amount of the unpaid annual withdrawal liability payments, plus accrued interest, if any, in whole or in part, without penalty.

Discuss payment of present value of twenty-year payments with Pension Fund Trustees.

Default. ERISA §4219(c)(5).

If an employer defaults in payment of its withdrawal liability, **the plan sponsor may require immediate payment of the balance of the employer's withdrawal liability** plus any accrued interest from the due date of the first payment which was not timely made. Default occurs if the employer fails to make any payment of its withdrawal liability when due and then fails to make payment within sixty days after receiving written notice from the plan sponsor of such failure.

RESOLUTION OF DISPUTES CONCERNING WITHDRAWAL LIABILITY

Request for Review of Plan Sponsor's Determinations. ERISA §4219(b)(2).

An employer may *request* that the plan sponsor review any specific matter relating to the determination of the employer's withdrawal liability and schedule of payments ***within ninety days after the employer receives the initial notice*** and demand for payment of its liability. During the ninety-day period, the employer may identify any inaccuracies in the determination of the amount of the employer's withdrawal liability and furnish the plan sponsor with any additional relevant information.

Arbitration Proceeding. ERISA §4221.

Any dispute between an employer and the plan sponsor relating to withdrawal liability is to be resolved through an arbitration proceeding. Either party may ***initiate the arbitration proceeding within a sixty day period following the earlier of (1) the date the plan sponsor notifies the employer of its decision*** *after a reasonable review of any matter raised under ERISA §4219(b)(2)(B);* ***or (2) 120 days after the employer requests a review of the plan sponsor's determination of withdrawal liability*** under ERISA §4219(b)(2)(A). The plan sponsor and the employer may jointly initiate arbitration within a 180-day period following the date of the plan sponsor's initial notice of withdrawal liability and demand for payment.

Payments During Arbitration Period. ERISA §§4221(b)(1) and (d).

Pending resolution of the dispute and during arbitration, the employer is required to pay withdrawal liability payments in accordance with the determinations made by the plan sponsor.

Preservation of Rights by Employer.

It is critically important that an employer take immediate action to preserve its rights if it receives a notice of withdrawal liability from a multi-employer plan. *If the employer fails to request a review of the plan sponsor's determinations and does not request arbitration within the appropriate time periods, the employer may have waived all of its rights to challenge the assessment of the withdrawal liability.*

EMPLOYER LIABILITY

Controlled Group.

Definition of an "Employer" for Withdrawal Liability Purposes. ERISA §4001(b)(1).

For purposes of Title IV of ERISA, all employees of trades or businesses (whether or not incorporated) which are under common control shall be treated as employed by a single employer and all such commonly controlled trades and businesses are treated as a single employer.

The regulations issued under §414(c) of the Internal Revenue Code define a controlled group of corporations for all purposes under Title IV of ERISA, including multi-employer pension plan withdrawal liability.

Parent-Subsidiary Controlled Group.

A parent-subsidiary controlled group is defined as one or more chains of businesses connected through ownership with a common parent organization if at least **80% of the control or value** of the organizations is controlled by one organization. IRC §1563(a)(1). Eighty Percent control is defined as a **"controlling interest"**. Treas. Reg. §1.414(c)(2)(b).

Brother-Sister Controlled Group.

A *brother-sister controlled* group is defined as two or more organizations conducting trades or businesses if (1) the same five or fewer persons own, singly or in combination, a **controlling interest** (defined as at least **eighty percent of the voting power or total value of stock**) of each organization; **and (2)** taking into account the ownership of each such person only to the extent such ownership is identical with respect to each such organization, such persons are in **effective control** (defined as **more than fifty percent of the voting power or value of the stock**) of each organization. IRC §§414(b) and (c), 1563(a). Treas. Reg. §1.414(c)-2(c).

The business must be involved in a **"Trade or Business"**. A Trade or Businesses must be regular and continuous and performed with a profit motive, even if not profitable.

Potential Personal Liability for Sole Proprietorships.

Sole proprietorships may be considered "employers" under the common control rules of IRC §414(c) for purposes of determining withdrawal liability.

Sole owners of corporations who were also sole proprietors of real estate activities, leasing and consulting services, or real estate leasing activities have been found to satisfy the common control test and the sole proprietors have been held liable for the withdrawal liability of the commonly controlled corporations.

- **Sun Capital** — Possible Controlled Group Expansion.

  Two cases involving an investment by private equity fund sponsors appear to have expanded potential controlled group liability in some circumstances.

In ***Sun Capital Partners III, LP v. New England Teamsters and Trucking Industry Pension Fund***, 724 F.3d 129 (1st Cir. 2013), the First Circuit held that pursuant to an ***"investment plus"* test**, a private investment fund was engaged in a trade or business and could be part of a controlled group with a company owned or partially owned as part of its investment portfolio.

In ***Sun Capital Partners III, LP v. New England Teamsters and Trucking Industry Pension Fund***, No. 10-10921 – DPW, 2016 WL 1239918 (D.Mass. 2016), the district court held that two separate Investment Funds (Fund III and Fund IV) operated by Sun Capital constituted a ***"partnership-in-fact"*** that was engaged in a trade or business with an underlying company owned by both Funds and, thus, constituted a controlled group with such company. As members of a controlled group, Fund III and Fund IV were jointly and severally liable for withdrawal liability with the other company.

Fund III and Fund IV, respectfully, owned 30% and 70% of Scott Brass, Inc. Scott Brass went into bankruptcy and defaulted on its withdrawal liability obligations to the New England Teamsters and Trucking Industry Pension Fund. Based on the investment plus test, the First Circuit determined that the Sun Capital Funds III and IV were more than just passive investors and were engaged in a trade or business with Scott Brass for purposes of the controlled group rules.

The District Court held that Fund III and Fund IV engaged in joint activity when deciding to invest in Scott Brass and in the management of the company. As such, the ownership percentages of Fund III and Fund IV could be lumped together as a "partnership-in-fact" for controlled group analysis. Since the combined percentages of Fund III and Fund IV exceeded 80% of the stock of Scott Brass, the three entities constituted a controlled group.

- **Successor Employer Liability.**

Under the common law, an asset purchaser does not assume the liabilities of an asset seller. Starting with ***Golden State Bottling Co. v. NLRB***, 414 U.S. 168 (1973), however, the U.S. Supreme Court signaled that a successor liability exception may apply for certain labor and employment related issues.

The Seventh Circuit applied the doctrine to withdrawal liability in ***Chicago Truck Drivers, Helpers & Warehouse Workers Pension Fund v. Tasemkin, Inc.***, 59 F.3d 48 (7th Cir. 1995). The court noted that the doctrine of successor liability could apply if a court found both:

- the **successor had notice of the predecessor's liability**, and
- there was **substantial continuity in the operation of the businesses** before and after the sale.

Indices of continuity includes continuity of workforce, management, equipment and location, constancy of customers, and completion of work orders begun by the predecessor.

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In ***Tsareff v. ManWeb Services, Inc.***, 794 F.3d 841 (7th Cir. 2015), the Seventh Circuit expanded its application of the successor liability doctrine in the withdrawal liability context. In ***Tsareff***, a unionized electrical contractor (Tiernan) sold its assets to a non-union employer (ManWeb). As a result of the sale, Tiernan ceased operations and ceased contributions to a multiemployer pension fund. The Fund asserted that this resulted in a complete withdrawal and assessed withdrawal liability. Tiernan failed to seek review or arbitration and the Fund filed suit against Tiernan and ManWeb (as a successor employer).

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The Seventh Circuit held that **notice of contingent withdrawal liability is sufficient to satisfy the notice requirement** and that ManWeb's notice of contingent liability could be "both reasonably inferred and directly proven by evidence in the record." In support of this position, the Seventh Circuit cited provisions in the asset purchase agreement stating that ManWeb was not obligated to assume any liability or obligation "arising out of or related to union related activities, including, without limitation, pension obligations."

In ***Resilient Floor Covering Pension Trust Fund v. Michael's Floor Covering, Inc.***, 801 F.3d 1079 (9th Cir. 2015), the Ninth Circuit extended the successor employer liability theory to a subsequent employer that had purchased certain assets of a predecessor employer at a public auction.

In ***Resilient***, Studer's Floor Covering, Inc. ceased doing business and ceased making contributions to a construction industry multiemployer pension fund. A former salesman of Studer's started Michael's Floor Covering, Inc. and continued in the floor covering business. Michael's hired five of Studer's former employees, leased the same premises, obtained the same phone number, used similar signage and purchased 30% of Studer's tools, equipment and inventory at a public auction.

The **parties did not have a contractual relationship** and no transfer of customer lists or customer information occurred between Studer's and Michael's.

The Ninth Circuit held that there was no reason why the successorship doctrine should not apply to either MPPAA withdrawal liability generally or to the construction industry exception in particular so long as the successor had notice of the liability.

The Ninth Circuit gave significant weight to the portion of Studer's business that Michael's retained (the ***"market share capture"***) and stated that the focus should be the relative amount of revenue generated by Studer's former customers.

Corporate Alter-Ego Issues.

It is possible for two unrelated entities (not members of a controlled group) to be held jointly liable for withdrawal liability under an "Alter-Ego" theory.

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In ***Local 134 Board of Trustees of the Toledo Roofers Pension Plan v. Enterprise Roofing and Sheet Metal Co. and Enterprise Roofing and Remodeling Surfaces, Inc.***, Case No. 3:10CV1869 (N.D. Ohio 2013) Judge James Carr essentially provided a checklist for the determination of potential alter-ego status.

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In ***Enterprise***, Judge Carr found that two separate entities were both liable for the multiemployer pension plan liability triggered by one of the entities by holding that the two entities were related under an alter-ego theory. Judge Carr noted numerous factors showing that two different companies are essentially the same company for labor law and pension liability purposes under the alter-ego theory.

- The companies had the same or similar management;
- The companies had the same physical location;
- The companies shared phone lines or separate phone lines which ended up at the same phone;
- Family members owned both companies;
- The companies had similar names;
- There was lending of money between the companies (furthermore, the loans were neither documented nor repaid);

- The companies shared tools;
- The companies frequently serviced the same clients;
- There was confusion by the clients as to which company is which;
- The companies had similar ownership (although the companies were not members of a controlled group of corporations);
- The companies had some of the same officers; and
- The business of the companies overlapped to a considerable degree.