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Key Issues Involving Multiemployer Pension Plan Withdrawal Liability

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March 01, 2019

Employers who are considering using union labor should be aware of responsibilities they undertake by signing collective bargaining agreements (CBA). One such responsibility – contributing to a multiemployer pension plan (MEPP) – can have far-reaching effects. Agreeing to be bound by a CBA that requires contributions to a MEPP can result in, under certain circumstances, substantial withdrawal liability because many MEPPs currently are not 100 percent funded. Although a MEPP can continue to provide benefits for years while being less than 100 percent funded, an employer who decides to stop using union labor could be assessed its pro rata share of that underfunding as withdrawal liability.

What is a MEPP? MEPPs, generally, are defined benefit plans that provide benefits based on a formula in the plan document. In order to fund these benefits, the CBA will require employer contributions to be made, generally as an add-on to each participant's hourly wage. Union employees often work for more than one employer during their careers. To address this circumstance, many employers in the same industry contribute to one MEPP. For example, construction industry workers, such as carpenters, plumbers, electricians, bricklayers, operators, laborers, and teamsters, commonly participate in MEPPs, and an employer becomes responsible to contribute to a MEPP by signing a CBA with a union which requires such contributions. Generally, MEPPs are intended to remain in existence for indefinite periods of time into the future. That they are supported by contributions from many employers is supposed to make them more stable than single employer pension plans and, for much of their history, that has been the case. However, in the last 10 to 15 years, as labor markets have changed and the economy has gone through downturns which reduced the value of assets invested in the stock markets, MEPPs have become less stable.

Employer contributions, plus earnings, must generate enough revenue to pay the promised benefits. All defined benefit MEPPs use actuaries to evaluate the funding status of the plan. Although it is not a completely accurate way to determine how well the plan is capable of paying benefits, the funded status is a snapshot of the extent to which the plan has sufficient assets to pay the promised liabilities if the plan terminated on the date of the snapshot. Each year the actuary must determine the plan's funded status and certify that status to the United States Department of Treasury and the sponsor of the plan.

Why is a MEPP's funding status important? Because most benefits from defined benefit MEPPs are paid over time as an annuity type benefit, a defined benefit MEPP can operate for years with a funded status of less than 100 percent. However, defined benefit MEPPs are subject to funding rules in the Internal Revenue Code to ensure they have sufficient resources from which to pay promised benefits. The funding rules label such plans as a way to highlight their ongoing ability to pay promised benefits.

When considering using union labor and signing a CBA, employers should know the funded status of the MEPP to help avoid a situation where they are required to contribute to a plan that is hopelessly underfunded. For example, plans that are at least 80 percent funded are considered to be in "green" status because they are, for the foreseeable future, likely able to pay benefits without changes to the employer's contributions or participant's benefits. If the plan's funded ratio is between 79 percent and 65 percent, the plan is in endangered or "orange" status, and it must adopt a funding improvement plan. A plan whose funded ratio is less than 65

percent is in critical or "red" status, and it must adopt a rehabilitation plan. Finally, a plan is in "critical and declining status" (there is no color coding for this status) if the plan actuary projects the plan will become insolvent within the current year or within the next 14 to 19 years; in general, such plans must provide specific notices to interested parties and may reduce benefits in pay status in some circumstances.

Depending on a MEPP's funding status, various statutory requirements exist to help increase the funding of a plan or otherwise to help keep it operational, even if to a lesser degree. There may be a combination of reductions to future benefit accruals and increases in employer contributions; reductions in adjustable benefits; a rehabilitation period during which there is monitoring; or a freeze in benefits, but there is a limit on the extent to which benefits for certain age participants can be reduced. If a defined benefit MEPP becomes insolvent, the Pension Benefit Guaranty Corporation (PBGC) will step in and guarantee a minimum level of benefits. If such a plan is in critical and declining status and desires to reduce benefits to participants in pay status, it can only reduce them to an amount which is 110 percent of the amount that the PBGC would guarantee if the plan becomes insolvent.

While these methods of shoring up the funded status of defined benefit MEPPs may cause increases in employer contributions, employers' contributions are otherwise set by the CBA. Employers will be given notice of any increases in contribution amounts proposed because a plan is in endangered or critical status and may vote not to agree with such increases. More importantly, an employer that is bound by one or more CBAs to contribute to a MEPP should become knowledgeable about and, if necessary, involved with the plan by, for example, assisting in determining what changes to contribution rates and future benefit accruals should be made to protect the plan from becoming insolvent. Sitting on the board of a MEPP is another way to help protect the employer's interests.

What happens if an employer wants to leave a MEPP? As a practical matter, employers may withdraw from a MEPP and incur withdrawal liability. When an employer withdraws from an underfunded MEPP and does not pay any withdrawal liability, it increases the unfunded status of the plan and puts more pressure on the remaining employers to continue to fund the plan. In some cases, such employers may avoid paying withdrawal liability either because they are entitled to an exception to the withdrawal liability rules or because they are in bankruptcy or unable to pay the withdrawal liability.

The rules for contesting withdrawal liability found in the Employee Retirement Income Security Act of 1974, as amended (ERISA), are very specific and must be followed to the letter. For example, if an employer receives a notice of withdrawal liability and desires to contest that liability, the employer must request, in writing, a review of the assessment by the sponsoring plan. Such request must be made within 90 days of the date of the withdrawal liability demand. If a request is not timely made, further steps, such as arbitration, are barred.

Once a request for review is made, arbitration may be initiated by either party within 60 days after the plan sponsor notifies the employer of its final determination of liability or, if earlier, within 120 days of the employer's seeking review of the determination. Again, failure to demand arbitration within this time period can result in denial of arbitration. Withdrawal liability is generally payable in installments over a 20-year period. ERISA requires that an employer who intends to contest the withdrawal liability pay the installment payments while contesting the liability. If an employer fails to pay the installment payments when due, even if the employer is contesting the liability, the plan sponsor may consider the employer to be in default and demand immediate payment of the entire withdrawal liability amount.

Further, any employer in a group of trades or business under common control may be considered to be responsible for the withdrawal liability of another employer in that same group. This can affect the owner of a small business if that owner also maintains a sole proprietorship that even engages in an unrelated business.

Does an employer have any good defenses? One defense is the construction industry exception. Many multiemployer pension plans are sponsored by construction unions, and some other plans, such as many of the Teamsters plans, specifically contain language that provides that they are subject to the construction industry exception. If at least 85 percent of the employees for whom an employer contributes to such a plan are in the construction industry and the employer ceases to make contributions to the plan even though it continues to be obligated to contribute, and makes no contributions for at least five years, it can invoke the construction industry exception and avoid withdrawal liability.

Another way an employer can limit its withdrawal liability is by using the 20-year rule. This rule is based on the fact that withdrawal liability, which is generally paid in monthly, quarterly, or annual installments, is supposed to bear some relationship to the monthly pension contributions made by the employer when it was actively contributing. If that is the case and the employer pays those withdrawal liability payments for 20 years, it can stop making payments, even if it has not paid the entire withdrawal liability that was assessed. However, if there is a mass withdrawal from a MEPP, the 20-year rule goes away and all the withdrawing employers must pay the full withdrawal liability.

Can withdrawal liability be imposed in other circumstances? Another way to incur potential withdrawal liability is to purchase the stock or assets of another business. If a buyer purchases the stock of another business, and if the business is contributing to an underfunded MEPP, the buyer will assume that obligation and liability. If the buyer purchases assets, there is a different dynamic at play. The sale of assets and termination of employment of employees by a seller who is subject to a CBA requiring contributions to a defined benefit MEPP will trigger withdrawal liability for that seller. If the sale is a bona fide arm's-length transaction between unrelated parties and the purchaser agrees to adopt the CBA and be bound by it, the seller should not incur withdrawal liability. Therefore, the law allows the parties to agree that if the purchaser makes contributions for substantially the same number of employees for a period of at least five years, the seller will only be secondarily liable for any withdrawal liability. The buyer, however, must purchase a bond to cover that obligation and, if the buyer ceases to make contributions during the five-year period and does not pay the full withdrawal liability, the seller is then liable for any portion of withdrawal liability not paid by the buyer. If, within the five-year period, the buyer decides to sell the same assets and cease to employ those employees associated with those assets, it must go through the same procedure and it will become secondarily liable for withdrawal liability if the buyer of those assets ceases to make the required contributions. The statute is not clear on whether the seller continues to be secondarily liable after the end of the five-year period.

All in all, if an employer is considering using union labor, it should look into the status of any MEPPs and keep these issues in mind when making that decision.

For assistance with multiemployer pension plans, please contact the authors, Cameron Hill and William Robinson, or any member of Baker Donelson's Labor & Employment Group.

This article originally appeared in the Winter 2019 issue of the Maryland State Bar Association Section of Labor & Employment Law Newsletter.