Pension Plan Withdrawal Liability: A Primer

By M. Trevor Lyons, Michael A. Shadiack and Peter J. Smith

All contractors are aware of the present financial crisis and its effect on the value of securities and other investments in recent years. Not only has this crises contributed to the failure of key businesses, and the decline in consumer wealth and economic activity, but it has also caused many pension plans to become under-funded. Faced with potential withdrawal liability to the pension plans, contractors need to know what withdrawal liability is and how to identify and potentially minimize its financial consequences. Of course, because the rules governing withdrawal liability are complicated, contractors with specific issues and concerns should consult with legal counsel.

What Is Withdrawal Liability?

Withdrawal liability is essentially an exit fee requiring an employer to pay a share of a pension plan's costs (future vested benefits), which have not been funded through previous contributions or investment returns. While an employer's withdrawal liability amount is based upon complicated actuarial calculations, it is basically a share of the plan's unfunded vested benefits ("UVBs") based upon a ratio of an 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 pension plan will generally have withdrawal liability equal to approximately one percent of the plan's UVBs. The rules governing withdrawal liability are found in the Multiemployer Pension Plan Amendments Act of 1980 ("MPPAA"), which amended the Employee Retirement Income Security Act of 1974 ("ERISA") to impose withdrawal liability upon employers who cease contributions to a multi-employer defined benefit pension plan with unfunded vested benefits. Withdrawal liability, however, generally only applies to multi-employer defined benefit pension plans; it does not apply to health and welfare plans, annuity plans or other defined contribution plans, although some of these types of plans attempt to create withdrawal-type liability by contract.

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What Acts or Circumstances Trigger Withdrawal Liability?

There are several circumstances under which a plan may assess withdrawal liability against a contractor. The most common instances in which withdrawal liability is assessed are when there is a complete or a partial withdrawal from the plan as follows:

A. Complete Withdrawal

A complete withdrawal from a pension plan will occur when a contractor either:

1. Permanently ceases to have a current obligation to contribute; or
2. Permanently ceases all covered operations under the plan.

B. Partial Withdrawal

A partial withdrawal from a pension plan will occur when there is a:

1. 70 percent contribution decline measured over a three-year period; or
2. Partial cessation of the contractor's contributions to the plan under one or more but not all collective bargaining agreements requiring contributions to the plan and the contractor continues to perform work in the jurisdiction or transfers such work to another location; or

3. Permanent cessation of an obligation to contribute with respect to work performed at one or more but not all facilities but the contractor continues to perform work at the facility of the type for which contributions were previously required.

In other words, subject to the exception discussed below, withdrawal liability can be triggered by any significant reduction in the duty to contribute, including work changes, layoffs, plant closures, sales, or even changes in a bargaining agreement.

What Is The Construction Industry Exemption And How Does It Function?

ERISA provides for certain exemptions from the withdrawal liability rules for certain industries (construction, entertainment, trucking, household moving, and public warehousing), and also for new employers (the so-called six-year "free look" exception). The construction industry exemption provides that an employer who will no longer be performing work in the jurisdiction of the collective bargaining agreement of the type for which contributions to the plan were previously required may withdraw from a multiemployer pension plan without liability. However, the exception does not apply where:

(1) the contractor continues to perform work in the jurisdiction of the collective bargaining agreement of the type for which contributions to the plan were previously required, or resumes such work within five years after the date on which the obligation to contribute under the plan ceases, and

(2) the contractor does not renew the obligation to contribute at the time of such resumption.

Therefore, if a construction industry employer goes out of business, under the provisions of this rule, withdrawal liability would not be assessed. If, however, the employer continued to work in the same jurisdiction (ostensibly on a non-union basis), withdrawal liability could be assessed by the plan.

Under the construction industry exception, a partial withdrawal occurs only if the contractor's obligation to contribute under the plan is continued for no more than an insubstantial portion of the potentially covered work which the contractor performs in the craft and area jurisdiction of the collective bargaining agreement. In other words, a partial withdrawal occurs only when a contractor has substantially shifted its work mix in the jurisdiction so that only an insubstantial part of such work in the jurisdiction is covered or requires contributions to the plan.

For this rule to be applicable, substantially all of the employees with respect to whom the contractor has an obligation to contribute under the plan must perform work in the building and construction industry (generally 85 percent or more), and the plan must primarily cover employees in the building and construction industry, or the plan must be amended to provide that this exception applies.

Any person or entity acting directly or indirectly as an employer, including affiliates and trades or business (whether or not incorporated) under common control, can be held responsible for withdrawal liability.

Who Is Responsible For Paying Withdrawal Liability?

Any person or entity acting directly or indirectly as an employer, including affiliates and trades or business (whether or not incorporated) under common control, can be held responsible for withdrawal liability. Attempts to evade withdrawal liability by going out of business and resuming business under a different name have generally not been successful. Specifically, both applicable plans and the Pension Benefit Guaranty Corporation ("PBGC"), a federal corporation created and empowered to protect pension plans, have simply disregarded such efforts to avoid withdrawal liability, and assessed such liability against the successor entity.

How Is Withdrawal Liability Enforced?

If a plan, through its administrators and trustees, believes an employer has withdrawn from the plan, it will generally investigate the circumstances and request information from the employer, usually in a document called a statement of business affairs. The plan generally has the legal right to receive the information requested.

If the plan does make a withdrawal liability assessment, the employer has 90 days to contest the assessment and request review by the plan. If the employer does not request a review by the plan during that period, arbitration is barred and the assessment is final. Arbitration is available if a request is made within 60 days after the plan notifies the employer of its final determination, or if earlier, within 120 days of the date the employer seeks the initial review, or arbitration may also be initiated jointly within 180 days of plan's initial determination. During any review period, the employer must pay installments of any assessed withdrawal liability.

What To Do To Address Withdrawal Liability Concerns?

1. **Avoid Defined Benefit Plans.** To the extent possible, avoid entering into labor agreements that require contributions to a defined benefit plan. Whenever possible, such as when negotiating a collective bargaining agreement, offer individual retirement benefits such as 401k plans and other financial incentives to employees in lieu of participation in a defined benefit plan.
2. **Know Your Liability.** A contractor has the legal right to request in writing from a plan an estimate of the contractor's potential withdrawal liability. A letter should be sent annually to each multi-employer pension plan to which you contribute requesting such an estimate so that you are aware of your potential withdrawal liability.
3. **Know What Is Being Done About Your Liability.** Defined benefit plans typically have management trustees, who are generally appointed by an employer association. Contact any employer association and the individual management trustees to determine what steps are being taken to reduce or eliminate a plan's withdrawal liability. This entities should also generally be contacted about addressing exorbitant or substantial UVB assessments via the collective bargaining process, and obtaining substantial financial concessions when greater contribution rates are required to prevent a plan from becoming critical or subject to mandatory remedial action and government supervision under the Pension Protection Act ("PPA") of 2006.
4. **Make Business Decisions that Allow for Withdrawal Liability.** After determining your withdrawal liability, make business decisions that reflect or account for that liability. In certain circumstances withdrawal liability may be preferable to continuing an obligation to contribute to a plan, and facing the surcharges that will attach if the financial condition of the plan is deemed critical under the PPA.

With the recent decreased participation in defined benefit plans, their increasing liabilities and their overall poor investment performance in the last few years, most plans are only going to become more insufficiently funded in the immediate future. This will generally result in greater withdrawal liability for contributing employers. Accordingly, for under-funded plans, proactive and preventative rehabilitative efforts and strategies need to be put in place before such plans are subject to government required rehabilitative measures under the PPA. One way to address insufficient funding is to make increased contribution amounts the subject of negotiations in future collective bargaining agreements. Given that such contribution rates will almost always represent an increased cost for construction industry contractors, they may want to seek other financial concessions in negotiations for these increased contribution amounts.

Accordingly, for under-funded plans, proactive and preventative rehabilitative efforts and strategies need to be put in place before such plans are subject to government required rehabilitative measures under the PPA.

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