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Multiemployer Withdrawal Liability: Understanding the Basics

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Introduction

The imposition of withdrawal liability is a statutory mechanism designed to dissuade employers from withdrawing from participation in multiemployer pension plans. The rules governing withdrawal liability are found in the Multiemployer Pension Plan Amendments Act of 1980, which amended ERISA to impose withdrawal liability upon employers that cease contributions to a multiemployer defined benefit pension plan with unfunded vested benefits. Plan fiduciaries are required to (1) determine the amount of liability, (2) notify the employer of the amount of liability and (3) collect the liability.

Understanding withdrawal liability means acknowledging that there is very little subjective application to the process. It is a creation of statute subject to strict enforcement, not generally a situation where a plan decides to apply the liability or not, and the numbers used to calculate the liability are not subject to great discretion in their computation. The liability of a withdrawing employer is calculated according to statute and collected according to statute, and failure to satisfy withdrawal liability is punished under the statutes.

Withdrawal liability applies only to multiemployer defined benefit pension plans, not to defined contribution plans (such as annuity or 401(K) plans) or to welfare plans.

What follows is a generally summary of the basic concepts impacting an employer in a withdrawal scenario. Because each withdrawal is factually specific to the employer and the fund involved, it cannot be assumed that all concepts apply in every situation. However, these basics will help explain how withdrawal liability works.

Withdrawal Liability Defined

Generally, the funding status of a plan is determined each year by the plan's actuary and is reported on an annual basis on the Form 5500. Underfunding occurs when the actuarial value of a plan's vested accrued benefits (the promised future benefits that participants have earned a right to receive) exceeds the value of the plan's assets. Thus, there would be unfunded, vested benefits that have to be attributed out to a withdrawing employer.

These calculations are influenced by various assumptions (investment rate of return, mortality, contribution hours, etc.) and by the level of benefits promised to participants. For example, if the plan does not meet its investment return assumption or has less than anticipated employer contributions, an imbalance may result and unfunded vested benefits may be created or increase. Trustees of a plan are obligated to be prudent in their decisions of the various assumptions to use in maintaining the plan, so trustees may change assumptions from time to time, which could increase or decrease unfunded liability.

Withdrawal liability is essentially an exit fee requiring an employer to pay its share of a plan's costs (future vested benefits) that have not been paid through previous contributions or investment returns. ERISA Section 4211 provides the formulas for calculating withdrawal liability.

The law sets out various allocation formulas that a plan can use for determining an employer's withdrawal liability. In addition, other methods can be approved by the Pension Benefit Guaranty Corporation (PBGC). The two basic types of allocation methods described in the law are:

1. The direct attribution method, which requires tracing of the unfunded vested benefits (UVBs) attributable to the employer's employees, and
2. The pro rata method, which allocates liability in proportion to the employer's share of the contributions over a specified period.

Under Section 4211(c)(4) of ERISA (the "direct attribution method"), an employer's withdrawal liability is based generally on the benefits and assets attributable to participants' service with the employer as of the end of the plan year preceding the employer's withdrawal; the employer is also liable for a proportional share of any UVBs that are not attributable to service with employers that have an obligation to contribute under the plan in the plan year preceding the withdrawal.

Under Section 4211(c)(3) of ERISA (the "pro-rata" or "rolling-5 method"), a withdrawing employer is liable for a share of the plan's UVBs as of the end of the plan year preceding the employer's withdrawal (less outstanding claims for withdrawal liability that can reasonably be expected to be collected), allocated in proportion to the employer's share of total plan contributions for the last five plan years ending before the withdrawal. A fraction is created using the total of the withdrawing employer's contributions for a five-year period divided by the total contributions for all employers during the same period. This formula is applied against the unfunded vested liability for the fund as a whole to determine that portion of the "unfunded liability" applies to the withdrawing employer.

Types of Withdrawal

An employer that withdraws from participation in a multiemployer plan may do so either in a complete or partial withdrawal. If the plan has UVBs allocable to the employer, the plan will assess withdrawal liability. The plan determines the amount of liability, notifies the employer of the amount and collects it from the employer.

1. Complete Withdrawal

Under Section 4203 of ERISA, a “complete withdrawal” occurs when an employer (1) permanently ceases to have a contribution obligation to contribute under the plan or (2) permanently ceases all covered operations under the plan. For example, if an employer goes out of business, it has had a complete withdrawal because it has ceased all covered operations. If the employer ceases to be covered by a collective bargaining agreement, it has had a complete withdrawal by virtue of the fact that it has ceased having a contribution obligation.

Special withdrawal liability rules apply to plans and employers in certain industries, such as construction, or less frequently, trucking. The law offers protection to an employer that temporarily suspends contributions during a labor dispute with the employer’s employees (generally strikes and lockouts).

Under Section 4218, a withdrawal does not occur solely because an employer ceases to exist by reason of a change in corporate structure or a change to an unincorporated business enterprise, provided the change causes no interruption in employer contributions or obligations to contribute to the plan.

2. Partial Withdrawal

To ensure that employers that gradually reduce their contributions to a multiemployer plan do not escape withdrawal liability, ERISA has rules under which a partial cessation of the employer's obligation to contribute would trigger liability. A partial withdrawal occurs when there is:

1. A decline of 70 percent or more in the employer's "contribution base units," or

2. A partial cessation of the employer's obligation to contribute.

A "contribution base unit" is the unit by which the employer's contribution is measured (e.g., hours worked, individuals employed per month, tons of coal mined, containers handled). The 70 percent decline is measured through a formula in ERISA that looks at the employer's contribution base units over a period of time.

While partial withdrawals occur as a result of a decrease in contributions, every decrease does not automatically trigger a partial withdrawal. The two type of partial withdrawal, the “70 percent contribution decline” and the “partial cessation of contribution obligations” require separate analysis.

70 Percent Contribution Decline

A 70 percent contribution decline that constitutes a partial withdrawal occurs if, during each plan year in the "three-year testing period" (i.e., the plan year in which the withdrawal allegedly occurred and the immediately preceding two plan years), the employer's "contribution base units" do not exceed 30 percent of its contribution base units for the "high base year." The total number of contribution units for the high base year is an average number of contribution base units for the two plan years in which the employer's contribution base units were the highest, within the five plan years immediately preceding the three-year testing period.

By way of example, assume an employer contributes to a multiemployer plan based on hours worked. An employer contributed the following number of hours for plan years as follows: (1998) 48,000; (1999) 52,000; (2000) 54,000; (2001) 51,000; and (2002) 48,000. The employer contributed for 15,000 hours in 2003, 13,000 hours in 2004 and 10,000 in 2005. The "three year testing period" for determining whether the employer had a partial withdrawal in 2005 is 2003-2005 (the plan year in which the withdrawal allegedly occurred and the two immediately preceding plan years). The company’s contribution base

units for the high base year was 53,000 – the average number of contribution base units for the two "highest" plan years in the five plan years immediately preceding the three year testing period (52,000 in 1999 and 54,000 in 2000). The company's contribution base units for each plan year in the three-year testing period (2003-2005) do not exceed 30 percent of 53,000 (or 15,900). Thus, there was a 70 percent contribution decline and a partial withdrawal in 2005, the end of the three-year testing period after the initial trigger.

Partial Cessation of the Obligation To Contribute

A partial cessation occurs in one of two ways:

1. The employer permanently ceases to have an obligation to contribute under one or more but fewer than all collective bargaining agreements under which the employer has been obligated to contribute to the plan but continues to perform work in the jurisdiction of the collective bargaining agreement of the type for which contributions were previously required or transfers such work to another location; or

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

An example would be an employer that operates four union facilities that are under a contribution obligation pursuant to four separate collective bargaining agreements. At one facility, the agreement expires and is not renewed, but the employer continues to perform work at that facility. There is a partial withdrawal as to that facility that continues to operate as non-union.

The “partial cessation” test is designed to capture such things as:

1. A situation in which an employer is obligated to contribute to the plan under more than one bargaining agreement, and one of the agreements expires but the employer continues to per form work in the jurisdiction of the agreement without making contributions for the work, and

2. A situation in which the employer ceases to contribute for one or more of its facilities but continues to perform work at the facility for which the obligation ceased.

Payment of Withdrawal Liability

Section 4219(c) provides that an employer will pay an amount to satisfy the withdrawal liability in level annual payments computed on a statutory formula based on prior years contribution. The annual payment cap for payment of a *complete* withdrawal is determined as follows:

The amount of each annual payment shall be the product of:

1. The average annual number of contribution base units for the period of three consecutive plan years during the 10 consecutive plan years ending in the plan year immediately prior to the withdrawal, in which the number of contribution base units is highest, and,

2. The highest contribution rate at which the employer was obligated to contribute under the plan during the 10 plan years prior to the withdrawal, including the plan year in which the withdrawal occurs.

4219(c)(1)(B) provides that in the case of a single employer withdrawal, the annual payment is capped at 20 years or until the liability is paid in full with interest, whichever is shorter. Interest accrues on the full amount of the withdrawal liability at the rate of interest prescribed by the plan. However, the accrued interest is included in the annual cap payment and does not increase the overall annual cap.

An example of calculation of withdrawal liability payment in complete withdrawal, assuming a withdrawal in 2009:

	1999	2000	2001	2002	2003
Base Units in Hours	26000	18000	22000	22000	23000
Contribution Rate	$1	$1.05	$1.10	$1.10	$1.15

	2004	2005	2006	2007	2008
Base Units in Hours	18000	17000	15000	14000	15000
Contribution Rate	$1.20	$1.25	$1.25	$1.30	$1.35

The average of the three highest consecutive years in the 10 preceding the withdrawal year is 22333.33 (years 2001-2003). Multiply that number by the highest contribution rate for the preceding 10 years ($1.35), and the total annual cap payment would be $30,150. If the total withdrawal liability is $200,000, it would be paid off at the rate of $30,150 per year. Assuming interest, that would take roughly eight years. If total withdrawal liability were $2,000,000, the employer would make payments of $30,150 for 20 years and then cease payments. The liability is not paid off, but the statutory limit of 20 years applies.

In the event of a partial withdrawal, the formulas set out below create a fraction or percentage that is then applied to the payment requirements for complete withdrawal. The total liability payable in partial withdrawal, once computed using these formulas, reduces both the amount of withdrawal liability payable and the payment under the annual cap.

Valuation and Payment of Partial Withdrawal Liability

In either instance of partial withdrawal, only a portion of the withdrawal liability is applied to the employer. The amount of the withdrawal liability is measured the same as a complete withdrawal, which is computed based on the unfunded liability of the plan in the year immediately prior to the withdrawal. However, the triggering event, and ultimately the payment of that liability, is different depending on the type of partial withdrawal occurring.

In the case of a partial cessation of a contribution, payment of the withdrawal is determined to be the plan year in which the partial cessation occurs. The partial withdrawal liability valuation is then assessed based on the complete withdrawal liability for the year immediately prior to the withdrawal. The assessment of payment is then based on the following formula as prescribed in Section 4206:

$$\text{Total withdrawal liability multiplied by } \left(1 - \frac{\text{base contribution units for year following year of withdrawal}}{\text{average base units for five immediately prior to withdrawal year}}\right)$$

An example of partial withdrawal liability calculation, assuming partial withdrawal in 2007:

	1999	2000	2001	2002	2003
Base Units in Hours	26000	18000	22000	22000	23000

	2004	2005	2006	2007	2008
Base Units in Hours	18000	17000	15000	14000	15000

For payment purposes, a fraction is created under Section 4206:

The fraction creates a formula for base units of $(1-\frac{10000}{19000}) = 1-.526 = .474$

The total withdrawal liability is multiplied by .474 to show the amount assessed. In the case of a total withdrawal liability of $200,000, $94,800 would be due. Then it would be payable at the annual cap for complete withdrawal, decreased by that same formula, or $30,150 x .474 = $14,291.10.

In the case of a 70 percent decline in contributions, the partial withdrawal is not finalized until the end of the three-year testing period, but ultimately the total liability against which it is measured is the same as the liability for the year immediately prior to the year of the 70 percent decline using the following formula:

$$\text{Total withdrawal multiplied by } \left(1 - \frac{\text{base contribution units for year following year of withdrawal)}}{\text{average base units for five immediately prior to the three year testing period}}\right.$$

Note the difference in the denominator of the measurement fraction. The 70 percent decline partial withdrawal creates a three-year window where the employers contributions are essentially not considered for the purposes of making a withdrawal liability determination.

	2001	2002	2003	2004	2005
Base Units in Hours	22000	22000	23000	18000	17000

	2006	2007	2008	2009	2010
Base Units in Hours	15000	4000	4000	3500	3600

In 2007, the contribution base units dropped below 30 percent of the average of the two high years in the five-year testing period preceding the decrease (2002-2006, average 22,500, 30% of which is 6,750). So if for the three-year testing period, 2007-2009, all three years were below the 6,750 measurement, then a partial withdrawal occurs in 2009.

The Section 4206 fraction creates a formula for base units of

$$\left(1-\frac{3600}{19000}\right) = 1-.189 = .811$$

The total withdrawal liability is multiplied by .811 to show the amount assessed. In the case of a total withdrawal liability of $200,000, $162,200 would be due. Then it would be payable at the annual cap for complete withdrawal, decreased by that same formula, or $30,150 x .811 = $24,451,65.

Abatement of Partial Withdrawal Liability

Under Section 4208 of ERISA, payment of partial withdrawal liability can be reduced or abated if the employer's contribution levels increase. If for any two consecutive plan years following the plan year in which an employer has partially withdrawn, the number of contribution base units is not less than 90 percent of the "average base units" calculated in accordance with Section 4205, then there is no obligation to make partial withdrawal liability payments for the years after the second consecutive year.

In any plan year after a partial withdrawal for which the contribution base units exceed the average base units calculated under 4205, in lieu of payment of the partial withdrawal liability required under 4206, the employer may furnish a bond to the fund not to exceed 50 percent of the annual payment. If the employer exceeds 90 percent of the base units in the next year, the bond is cancelled and there is no further withdrawal. If the second year does not exceed 90 percent, the bond shall be paid to the plan and the employer makes up the difference in required annual payments and continues making the interim payments.

Also, for any two consecutive plan years following the partial withdrawal, if the employers contribution base units exceeds 30 percent of the high base year as calculated under 4205, AND the total contribution base units of all contributing employers for the two consecutive years is at least 90 percent of the total contribution base units of all employers contributed in the year of the partial withdrawal, the employer shall have no obligation to make further payments for partial withdrawal.

De Minimus Rule

Under Section 4209, withdrawal liability may be reduced by a so-called "de minimis reduction rule." Any withdrawal liability for an employer that withdraws from a plan shall be reduced by the smaller of:

(1) 3/4 of one percent of the plan's unfunded vested obligations (determined as of the end of the plan year ending before the date of withdrawal), or
(2) $50,000,

reduced by the amount, if any, by which the UVBs allowable to the employer, determined without regard to this subsection, exceed $100,000. The rule has the effect of exempting smaller employers or eliminating smaller withdrawal liabilities.

Mass Withdrawal

If all of the contributing employers withdraw, the plan is terminated under the law in a mass withdrawal. Liability for employers withdrawing within the plan year in which a mass withdrawal occurs will be calculated under the normal rules, except none of the relief provisions (such as the de minimis reduction or the 20-year cap for payments) would apply. Also, certain benefit reductions and suspensions apply.

In addition, employers that withdrew during the three years prior to the mass withdrawal are presumed to be part of the arrangement or agreement and are treated as if they had withdrawn in a mass withdrawal. The PBGC has issued regulations concerning the various administrative steps the plan must go through if a mass withdrawal occurs.

Special Rules for Certain Industries

In recognition of differing conditions in various industries, a series of special industry rules are in operation for:

- Building and construction
- Entertainment
- Trucking, household goods moving and public warehousing
- Retail food (Sec. 4205(c)) – for partial withdrawal

These rules modify the conditions under which a complete withdrawal occurs or when the employer is liable in the case of a partial withdrawal.

For construction industry plans and employers, Section 4203(b)(2) of ERISA provides that a complete withdrawal occurs only if an employer ceases to have an obligation to contribute under a plan, and the employer either continues to perform previously covered work in the jurisdiction of the collective bargaining agreement or resumes such work within five years without renewing the obligation to contribute at the time of resumption. Section 4203(c)(1) of ERISA applies the same special definition of complete withdrawal to the entertainment industry, except that the pertinent jurisdiction is the jurisdiction of the plan rather than the jurisdiction of the collective bargaining agreement.
In contrast, the general definition of complete withdrawal in Section 4203(a) of ERISA defines a withdrawal to include permanent cessation of the obligation to contribute regardless of the continued activities of the withdrawn employer.

Under Section 4203(d), a trucking employer will not be considered to have withdrawn from a plan within the meaning of a trucking industry

plan merely because the employer permanently ceases to have an obligation to contribute under the plan or permanently ceases all covered operations under the plan, if certain conditions are met. One condition is that the employer must not continue to perform work within the jurisdiction of the plan. Another condition is that the employer must furnish a bond or establish an escrow account in an amount equal to 50 percent of its withdrawal liability.

For certain retail food industry plans, the partial withdrawal liability rules are changed to provide that the 70 percent decline measurement for partial withdrawal is reduced to 35 percent.

Asset Sales

Withdrawal liability of employers that sell all or substantially all of their operating assets or are insolvent is limited by Section 4225 of the law. In the case of an asset sale, a graduated statutory schedule limits the employer's liability to 30 percent if the dissolution or liquidation value is $2 million or less, with a maximum of 80 percent if the value is more than $10 million. In order to qualify for the net worth limitation, the sale must be a bona fide sale to an unrelated party in an arm's length transaction. A withdrawal does not occur because of a cessation of contributions that results from a sale of assets to another employer, provided the sale meets certain conditions (Section 4204).

Under Section 4204, a transaction that results in the sale of assets of the contributing employer DOES NOT trigger a withdrawal if:

1. The purchaser retains an obligation to contribute to the fund in substantially the same number of contribution base units as the seller had prior to the purchase;
2. The purchaser provides a bond to the plan for a period of five plan years after the date of the purchase equal to the greater of (a) the average required contributions of the seller for the three years prior to the sale or (b) the amount of required contributions for the year immediately prior to the sale; and
3. The contract for sale includes a provision that the seller will remain secondarily liable for a purchaser withdrawal for a period of five plan years after the transaction.

If all or substantially all of the seller's remaining assets are distributed prior to the end of the fifth plan year after the transaction, the seller will

be required to post a bond equal to 100 percent of the withdrawal liability that seller would have occurred if the transaction had not met the exception.

Abatement of Withdrawal Liability in Liquidations

Section 4225 of ERISA provides two ways of limiting the amount of withdrawal liability depending on whether the employer is withdrawing on account of either a sale, or a liquidation or dissolution. Section 4225(a), which provides a chart of maximum withdrawal liability amounts for the sale of assets, specifically excludes "an employer undergoing reorganization under Title 11." Section 4225(b), which reduces the allocable withdrawal liability by 50 percent, covers "an insolvent employer undergoing liquidation or dissolution" but does not make reference to Chapter 7, the Bankruptcy Code title governing liquidations.

Arbitration of Withdrawal Liability Disputes

Any dispute between an employer and a multiemployer plan involving withdrawal liability must be submitted to arbitration, and the law sets up a procedure under which the arbitration must be conducted.

Section 4219 provides that an employer must provide fund information necessary to compute withdrawal liability within 30 days of receipt of a written request. Thereafter, the fund will issue a notice of withdrawal liability and payment schedule. No later than 90 days after receipt of the notice, the employer may dispute the liability determination and request a review of any specific matter or identify any inaccuracy as a challenge to the determination. The fund shall then provide a response to that dispute.

In any event, an employer is obligated to begin making scheduled withdrawal liability payments during the dispute time. Withdrawal liability is a pay first, dispute later arrangement. The first interim payment is due within 60 days of the initial notice of withdrawal. Thereafter, regular interim payments are required. A failure by the employer to make the required interim payments or to cure any default in required interim payments within 60 days of a notice of delinquent payment will result in a default, meaning that the entire withdrawal liability is due and owing in lump sum even if there is a pending dispute.

Arbitration shall be commenced the earlier of 60 days after the fund responds to dispute letter or 120 days after the date the dispute letter is sent.

Withdrawal liability extends to trades or business under common control as the withdrawing employer. The trades or business do not have to be in the same business or even a related business. The trigger is simply commonality of ownership and being a business enterprise. So an owner of the employer that also owns unrelated rental properties must include both enterprises as part of its control group. Three types of control groups are recognized under Internal Revenue Code Section 1563 that are applicable to withdrawal liability scenarios.

1. Parent-Subsidiary

When one or more corporations are connected through stock ownership with a common parent and:

(a) Stock possessing at least 80 percent of the total combined voting power of all classes of voting stock or at least 80 percent of the total value of the shares of all classes of stock of each of the corporations, except the common parent corporation, is owned by one or more of the other corporations, and
(b) The common parent corporation owns stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of all shares of stock of at least one of the other corporations, excluding, in calculating voting power or value, stock owned directly by those corporations.

2. Brother-Sister

Two or more corporations exist that are owned by five or fewer individuals, estates or trusts that own stock possessing:

(a) At least 80 percent of the total combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of shares of all classes of stock of each corporation, and
(b) More than 50 percent of the total combined voting power of all classes of stock entitled to vote or more than 50 percent of the total value of all shares of all classes of stock of each corporation, taking into account the stock ownership of each such person only to the extent such stock ownership is identical with respect to each corporation.

An individual's stock is taken into account under the 80 percent test only to the extent that the individual owns stock of each member of the controlled group.

3. Combined Group

This consists of three or more corporations, each being a member of a parent-subsidiary or brother-sister controlled group. One of the corporations must be a common parent included in a parent-subsidiary controlled group and included in a brother-sister controlled group.

Trades or businesses that are not corporations may be under common control and treated as a single employer for withdrawal liability purposes. These entities, though not corporations, will be treated as if they were corporations for the purposes of determining the percentage of ownership tests above. Control group entities are jointly and severally liable for withdrawal liability as the withdrawing employer.

Generally, an individual stockholder or officer of a corporation will not be liable for withdrawal liability and will not be considered as part of a "controlled group." However, personal liability can arise under a "piercing the corporate veil" theory where the shareholder or officer would otherwise be liable to the corporation or its creditors for actions taken. Also, an individual who is the owner of a non-corporate entity that does not provide for liability protection (such as a sole proprietorship or partnership) can be personally liable as a control group entity, as individual owners of non-limited liability entities have been held to meet the definition of "employer" under the withdrawal liability provisions.

Conclusion

The computation and assessment of withdrawal liability can be very cumbersome and should be carefully reviewed prior to employers taking any action that may trigger a complete or partial withdrawal. These concepts discussed here are only part of a much larger body of law that regulates multiemployer pension fund withdrawal liability, and each component requires deeper analysis to determine the impact of the current law on any proposed transaction.

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