TAX REFORM: IN THE CONSTRUCTION INDUSTRY

WITHDRAWAL LIABILITY AND RELATED ISSUES

The Pension Benefit Guaranty Corporation (PBGC) is projected to become insolvent in 2025, a mere eight years from now.[i] In fact, the projections show that the risk of insolvency grows rapidly after 2025, exceeding 99% in 2036.[ii] Also in 2025, the Central States Southeast and Southwest Areas Pension Plan ("Central States") is projected to run out of funds. The Central States Fund has over 400,000 participants.

The primary law governing pensions and any reductions in benefits is THE Employee Retirement Income Security Act ("ERISA"). ERISA § 204(g) prohibits a plan sponsor from amending a plan so as to reduce accrued pension benefits.[iii] However, in 2014 the Multiemployer Pension Relief Act ("MPRA") was passed. The MPRA, also known as the Kline-Miller Act, allows funds to cut benefits to participants after following a stringent application process overseen by the United States Department of Treasury, Department of Labor ("DOL"), and PBGC.[iv] Only three (3) applications out of nineteen (19) submitted by multi-employer funds have been approved at this point.[v] The Central States Fund, again projected to become insolvent by 2025 affecting 400,000 people, was not one of the Funds given the ability to cut benefits.[vi]

According to the Department of Labor's Employee Benefits Security Administration there are well over 100 Pension Funds that are either Endangered or Critical (Critical includes plans in Declining and Critical Status).[vii] The Central States Fund mentioned above is one of those funds in Critical and Declining status. Upon being declared either Critical or Declining, a Fund must provide notices regarding this status to plan participants, collective bargaining parties, and beneficiaries, as well as the DOL and the PBGC. The notice applies when there are funding or liquidity problems (or both).[viii] The notice lays out details for instituting a rehabilitation plan. The rehabilitation plan is designed to improve the funding/liquidity problems of the plan (or both). [ix]

The underfunding problem and associated issues discussed above play directly into an employer's withdrawal liability. Withdrawal liability is a contingent liability for all employers who contribute to multi-employer pension plans that are underfunded.[x] Although many people think of funding level in terms of percentage (i.e. 100% funded, 80%, etc.), because of timing issues, even if a plan is 100% funded there may be some withdrawal liability on the part of an employer.[xi]

Withdrawal liability was created when Congress enacted the Multiemployer Pension Plan Amendments Act of 1980 ("MPPAA").[xii] MPPAA was enacted to stop a mass exodus of employers leaving pension plans that were drastically underfunded to avoid a termination liability (which was created when Congress enacted ERISA). Prior to the enactment of MPPAA, if an employer stopped contributing to the plan for any reason there was typically no further obligation.[xiii] The Pension Protection Act of 2006 subsequently made minor changes to withdrawal liability rules and additionally modified the funding rules and procedures with special emphasis on plans with relatively weak levels of funding. [xiv]

The amount of withdrawal liability is the employer's proportionate share of the plan's unfunded vested liabilities, as determined under a statutory formula.[xv] A more simplistic definition would be withdrawal liability is the amount of plan underfunding that an employer who contributes to a multiemployer plan

must pay when leaving the plan. Employers in the construction industry, however, can avail themselves of the construction industry exemption. 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.[xvi] This means an employer must shut its doors (i.e. retire) to avail themselves of the construction industry exemption.

Although withdrawal liability is contingent, employers must consider their withdrawal liability when it comes to day-to-day operations (i.e. banking, bonding, and succession planning). Employers must be cognizant of the withdrawal liability as their business ebbs and flows. If their work declines and subsequently the work hours reported to the funds decline too much in a given period, they may be assessed partial withdrawal liability. If their work force is aging at a rapid pace (i.e. an older work force with retirements looming) they may be responsible for a withdrawal liability when those retirements kick in. Many banks require employers list the amount of liabilities they have when looking for a loan, purchasing new equipment, or seeking an infusion of capital from investors. These liabilities, if required by banks to be listed on an employer's balance sheet, also drastically reduce the capability to obtain a bond.[xvii] Lastly, companies that are family owned face the issue of transferring a large amount of withdrawal liability to future generations. Selling the business may not be much of an option as successors can sometimes be required to take on the withdrawal liability of a previous owner.

Compounding this issue is the amount of withdrawal liability is ever changing. An employer may be required to contribute to several funds based on the composition of their workforce. Each fund, which is typically comprised of an equal number of Management/Labor Trustees, has the option to utilize different assumptions (aggressive to conservative) when it comes to actuarial methods. As aforementioned withdrawal liability is based on unfunded vested liabilities. Therefore, changes to the actuarial assumptions (i.e. interest rates, return on investments, etc.) can increase withdrawal liability exponentially. One fund may use different more aggressive methods and models that increase an employer's withdrawal liability compared to other funds that are more conservative in nature.

However, there are areas in which the impact of withdrawal liability can be lessened. First, funds that are in poor financial condition need to review the method in which collectively bargained wage package increases are allocated. Allocation of the collectively bargained wage increases are done by the Labor side unilaterally in many cases.[xviii] While many multiemployer funds are jointly trusteed by labor and management, the trustees typically rely on actuaries to advise them on what level of contributions are needed to maintain the status quo (or to improve benefits). These actuaries often give the fund Trustees the minimum needed to comply with applicable laws. After the amount necessary to maintain benefit levels has been determined any additional amounts of an agreed upon wage package increase are allocated to other funds or to an employee's wages. Often times a fund that is at a funding level of 80% will see the agreed upon wage package increase allocated across multiple funds even with the fund being less than 100% funded.

Even if these plans are fully funded, withdrawal liability can remain although there are not too many multiemployer pension funds that are currently fully funded. In fact, a large amount of multiemployer funds throughout the country are struggling. As such, any increases to the overall wage package should go to completely reducing an employer's withdrawal liability until the funding level reaches a certain percentage, ideally 100% but no less than 90%. If the funding level reaches the benchmark percentage or it is already at that level the parties to the collective bargaining agreement should be required to jointly

allocate any increases to the overall wage package. If they cannot agree on joint allocation, a third party can be brought in to resolve the dispute. Once the fund level reaches 100% and there are no unfunded vested liabilities the plan should move from a defined benefit plan to a defined contribution plan.

Secondly, funds should seek approval from the various entities charged with fund oversight for a two-pool alternative withdrawal liability method. According to the PBGC, several plans have asked to use a two-pool alternative method.[xix] A two-pool alternative withdrawal liability arrangement may attract new employers or retain employers who would otherwise be reluctant to remain in a multiemployer plan due to the uncertainty of withdrawal liability costs. It could potentially extend plan solvency by providing needed income to the plan. As many plans are teetering on insolvency, an influx of income to the plan would be welcome news. There are downsides to a two-pool method however. Depending on its structure, it could also increase the risk of loss to plan participants and beneficiaries or to the multiemployer insurance program.[xx]

A more long-term thought process to stabilizing withdrawal liability would require a two-prong approach. First, Congress needs to come up with an infrastructure bill to improve on the nation's crumbling roads, bridges, railroads, communications, and energy resources. This would provide an influx of jobs in the trades increasing the number of hours employers would be contributing to multiemployer funds. Secondly, and just as important to the infrastructure bill would be an increased push to open the trades to a younger work force. Many of the funds that are in danger of becoming insolvent are "upside down". That is there are more retired members than active members. Reversing this trend will require a renewed push on a national, state, and local level. As more young people get involved in the trades, there will be more participants in the plan on which contributions will be made.

There are other areas that should also be looked at to reduce the impact withdrawal liability has on an employer and in turn their employees; moving to a hybrid retirement plan (defined contribution v. defined benefit plan), changing the amount in which the *de minimis* rule applies (currently at $150,000)[xxi], requiring funds to implement a minimum age requirement above the age of 60, and changing the accounting methods whereby an employer is required to calculate (or show) withdrawal liability on their balance sheets are just a few examples.

As tax reform is being discussed on a national level, now would be the time to address how this issue is handled. Any relief that can be gained by employers in this area would allow them to reinvest any savings in manpower and equipment.

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[i] https://www.pbgc.gov/news/press/releases/pr17-04
[ii] Id.
[iii] http://www.hreonline.com/HRE/print.jhtml?id=534358799
[iv] https://www.treasury.gov/services/Pages/Benefit-Suspensions.aspx
[v] http://www.pionline.com/article/20170913/ONLINE/170919939/new-york-state-teamsters-pension-fund-cuts-approved
[vi] http://www.ttnews.com/articles/about-114-multiemployer-pensions-deep-trouble
[vii] https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/public-disclosure/critical-status-notices
[viii] Id.
[ix] Id.
[x] http://www.law.com/insidecounsel/2013/03/11/labor-the-4-ws-of-withdrawal-liability/?slreturn=20171002100042
[xi] Id.

[xii] https://www.agc.org/sites/default/files/Galleries/labor_member_files/Withdrawal%20Liability%20-%20Widman.pdf

[xiv] https://www.vedderprice.com/-/media/files/vedder-thinking/publications/2015/05/updates-to-withdrawal-liability-to-multiemployer-p/files/2015-withdrawal-liability-to-multiemployer-pension/fileattachment/2015-withdrawal-liability-to-multiemployer-pension.pdf

[xv] Id.

[xvi] http://www.wickenslaw.com/wp-content/uploads/2012/01/Multi-Employer-Pension-Plan-Withdrawal-Liability.pdf

[xvii] Many collective bargaining agreements set the minimum level of bonding necessary for contractors. If these bonds prove more difficult to obtain (i.e. costs increase) a contractor may be forced to choose whether violate a provision in the agreement by failing to obtain a bond or pay an increased cost to obtain one causing cash strapped employers to become delinquent on fringe benefit contributions or even wages.

[xviii] Allocations are generally subject to a rehabilitation plan if one exists.

[xix] https://www.pbgc.gov/about-pbgc/who-we-are/retirement-matters/request-information-two-pool-withdrawal-liability

[xx] Id.

[xxi] Increasing that amount to $250,000