Overview of Withdrawal Liability Considerations in the Transfer and Sale of a Business

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Council of Chapter Representatives
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Understanding Withdrawal Liability

- Statutorily enacted with the Multiemployer Pension Plan Amendments Act of 1980 (MPPAA)
- Primary objective "is to protect retirees and workers who are participants in [multiemployer] plans against the loss of their pensions."
- Applies to underfunded, multiemployer defined benefit pension plans

Understanding Withdrawal Liability (cont'd.)

- Underfunding occurs when the actuarial value of the vested benefits exceeds the value of the plan's assets
- Why / how do unfunded vested benefits (UVBs) result?
    - Changes in benefit accrual rates, especially retroactive
    - Actuarial assumptions
    - Investment return
    - Mortality rates
    - Contribution hours
    - Employer bankruptcies
    - Interest rates
- An individual employer's withdrawal liability represents its allocable share of the plan's UVBs

Understanding Withdrawal Liability (cont'd.)

Pizza represents the Plan's UVBs

Slice represents an employer's Allocable Share of the UVBs

Building and Construction Industry Exemption

- To qualify for exemption, must be:
  - B&C employer – substantially all the employees with respect to whom the employer has an obligation to contribute under the plan perform work in the building and construction industry
  - NPF – 85% or more of employees spend 25% or more of their time in the field (jobsite work)
  - TAB qualifies
  - Fabrication and service do not qualify
- No withdrawal unless employer ceases to have an obligation to contribute and continues to perform work in the jurisdiction of the collective bargaining agreement of the type for which contributions were previously required
  - i.e. Operate non-union or negotiate out pension contributions

Calculating Withdrawal Liability

- Presumptive method
    - UVBs as of the last day of the plan year multiplied by fraction
    - Numerator is total contributions of that employer in that plan year and 4 preceding
    - Denominator is total contributions of all employers in that plan year and 4 preceding
    - Equals liability allocated for that year
    - Subsequent years, change in UVBs plus reallocated pools (portion of UVBs that cannot be collected or assessed, written down by 5% annually) multiplied by similar fraction

Calculating Withdrawal Liability

- Valuing UVBs
    - How should a plan value the UVBs? What interest rates?
        - Plan funding Method –
            - 6.5-7.5%?
        - “Segal Blend Method” –
            - Calculate liabilities 2x
            - Once using PBGC rates
            - Once using plan funding rate
            - Then use amount of plan assets to determine how much of each to use

NPF's UVBs Applying Segal Blend

SECTION 4: Actuarial Certification of Withdrawal Liability as of December 31, 2014 for the Sheet Metal Workers' National Pension Fund

EXHIBIT I
Calculation of Unfunded Vested Liability

The calculations include the following participants as of December 31, 2014	
a. Pensioners and beneficiaries (including 8,352 beneficiaries in pay status, 59 pensioners in suspended status, and 16 beneficiaries in suspended status)	46,501
b. Inactive participants with vested pension rights (including 86 beneficiaries with rights to deferred pensions and 38 participants with unknown age)	34,450
c. Active vested participants (including 11 participants with unknown age)	43,050

The actuarial factors are shown below as of December 31, 2014	
1. Present value of vested benefits at funding interest rate*	$6,644,379,756
2. Present value of vested benefits at PBGC interest rates, including allowance for expenses*	11,963,002,851
3. Market value of assets	4,027,502,324
4. Ratio funded at PBGC interest rates [(3) ÷ (2), not greater than 1.0]	0.336663
5. Present value of vested benefits for withdrawal liability purposes [(4) x (2) + (1.0 – (4)) x (1)]	$8,434,964,206
6. Unfunded vested liability [(5) – (3), not less than zero] (excluding Affected Benefits pools)	4,407,461,882
7. Unamortized balance of Affected Benefits pools	586,454,674

**Includes liabilities for 1,009 alternate payees in pay status and 546 alternate payees with deferred benefits who are excluded from the above counts*

Funding Rate (7.5%)

PBGC Rate 3.10%, 3.29%

Weighting

Blend

UVBs $4,407,461.882

Payment of Withdrawal Liability

- Payment scheduled designed to replicate contribution history throughout
  - Average annual number of CBUs for 3 consecutive years, during 10 year look back, where CBUs were highest, multiplied by
  - Highest contribution rate during 10 year look back
  - Capped at 20 years
- Controlled Group Liability
- Successor Liability
  - *Tsareff v. Manweb Services*
  - *Resilient Floor Covering Pension Fund v. Michael's Floor Covering, Inc.*

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Sale or Transfer

- Sale of Stock
    - Will not by itself trigger a withdrawal
    - Assumes continued obligation to contribute, without interruption
    - Contribution history of entity is unchanged
- Exception
    - Actively contemplated purpose of transaction, not just incidental benefit, was to “evade or avoid” withdrawal liability
    - Transaction structured as a stock sale, to a shell, dormant, judgment proof entity, will be disregarded

Sale or Transfer (cont'd.)

- Sale of Assets
  - Non-B&C employers
  - B&C employers
  - Importance of distinguishing and documenting whether company meets B&C test

§ 4204 Sale

- Available if there is a bona fide, arms-length sale of assets to an unrelated party
    - Not family; waivable?
- No withdrawal liability assessed upon sale of assets if:
    1. The purchaser has an obligation to contribute to the plan with respect to the [seller's] operations for substantially the same number of CBUs for which the seller had an obligation to contribute to the plan
    2. The purchaser provides to the plan for a period of five plans years commencing with the first plan year beginning after the sale of assets a bond issued by a corporate surety in an amount equal to the greater of –
        1. The average annual contribution required to be made by the seller with respect to the operations under the plan for the three plan years preceding the plan year in which the sale of assets occurred; or
        2. The annual contribution that the seller was required to make with respect to the operations under the plan for the last plan year before the plan year in which the sale of assets occurs.

§ 4204 Sale

- Purchaser's Bonding Requirements – Variances
- Must inform plan in writing of intent to comply with § 4204 and demonstrate to satisfaction of plan that criteria are satisfied
    - De minimis transaction - the amount of the bond or escrow does not exceed the lesser of $250,000 or 2% of the average total annual contributions made by all employers to the plan for the 3 prior plan years
        - NPF – total average contribution (2015) $361,666,232
            - 2% = $7,233,324.63
        - $250,000
    - Net income test – purchaser's average net income for 3 year look back equals or exceeds 150% of bond amount
    - Net tangible assets – purchaser's net assets are greater than either seller's withdrawal liability – in the case where buyer did not previously contribute – or the sum of buyer's and seller's withdrawal liability

§ 4204 Sale

- Conditions
  - If the purchaser withdraws before the last day of the fifth plan year beginning after the sale and fails to make any withdrawal liability payments when due, then the seller shall pay to the plan the missed withdrawal liability payments, not to exceed the amount of the seller's withdrawal liability that would have been due on the sale but for the application of Section 4204.
  - If all or substantially all of the seller's assets are distributed, or if the seller is liquidated before the end of the fifth plan year period described above, then the seller shall provide a bond or amount in escrow equal to the present value of the withdrawal liability the seller would have had but for the application of 4204.
  - The future withdrawal liability of the purchaser shall be determined as if the purchaser had been required to contribute to the plan in the year of the sale and the four plan years preceding the sale the amount the seller was required to contribute for the operations for such five plan years.
- Seller's Liquidation Bond
  - Waivable by Plan

§ 4204 Sale

- Contribution history
  - Buyer only assumes seller's 5 year contribution history
  - By structuring as a § 4204 sale, buyer is only assuming a fraction of what seller's withdrawal liability was
- Limiting Liability
  - Successor liability potential for purchaser

§ 4204 Sale

- Application to B&C Employer
  - Technically no withdrawal in connection with sale of assets
  - Certainty that the seller meets “substantially all” and NPF test

Considerations in Structuring Sale to Comply with § 4204

- If uncertainty as to whether meet B&C test, eliminates risk
- Using § 4204, seller only inherits 5 years of CBU history
- May bear on negotiations in purchase price
- Challenge in helping other party to deal understand technical aspects, overcoming stigma of withdrawal liability

Limitation on Liability Without a § 4204 Sale

- If § 4204 not complied with, § 4225 limits the liability in sale of assets to unrelated party to 30% of net amount received where sale is $5 million or less
    - Percentage increases with sale price
- Where employer undergoing liquidation is insolvent the liability is limited to ½ normal withdrawal liability, plus the portion of the 2nd half that does not exceed the liquidation value determined as of the beginning of the liquidation

Questions?

OVERVIEW OF WITHDRAWAL LIABILITY CONSIDERATIONS IN THE TRANSFER AND SALE OF A BUSINESS

SMACNA Council of Chapter Representatives

June 6, 2016
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This memo provides an overview of the withdrawal liability considerations involved in selling or transferring a business. Certain underlying aspects of withdrawal liability – how the amount of liability is calculated, determining the payment amounts, who is potentially liable – are beyond the scope of this narrow discussion, but should nonetheless be reviewed with competent ERISA counsel when exploring structuring a transaction.

I. Triggering Withdrawal Liability through the Sale of a Business

A. Sale of Stock

In general, if a business is organized as a corporation, a sale of stock does not trigger withdrawal liability.[1]

A sale of stock does not constitute a withdrawal from a multiemployer pension plan,[2] and therefore withdrawal liability does not need to be taken into account with such a transaction.

An exception exists if it can be shown that a transaction was structured as a stock sale in a sham transaction to escape withdrawal liability. If a principal purpose of any transaction is to "evade or avoid" liability,[3] then the plan can assess and seek to collect that liability as though the transaction had never occurred.

B. Sale of Assets

A sale of assets can, depending upon the nature of the work performed by the business' employees, result in an assessment of withdrawal liability. [4]

A contractor that satisfies the building and construction industry (B&C) exemption does not affect a withdrawal from a plan simply through a sale of assets.[5] A non-B&C contractor that sells its assets will trigger a withdrawal, however it can avoid that liability by structuring the sale to comply with § 4204 of ERISA.[6]

1. Building and Construction Industry Exemption

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[1] ERISA § 4218(1)(A); *PBGC Op. Ltr.* 82-4
[2] ERISA § 4218
[3] ERISA § 4212(c); *Santa Fe Pacific Corp. v. Central States,* 22 F.3d 725 (7thCir. 1994)
[4] ERISA § 4203; *PBGC Op. Ltr.* 91-3
[5] ERISA § 4203(b)(2); *PBGC Op. Ltr.* 81-19
[6] *PBGC Op. Ltr.* 90-1

If the multiemployer plan is a B&C plan, a B&C contractor is not deemed to have withdrawn from the plan unless it ceases to have an obligation to contribute to the plan, but continues to perform work in the jurisdiction of the CBA of the type for which contributions were previously required, within 5 years of the withdrawal.[7] This means that the contractor negotiated out of its CBA the obligation to contribute to the plan, or simply operated non-union. There are other issues that come into play with subcontracting following termination of a CBA. Depending upon the specific terms of the CBA the employer was bound to, subcontracting work to a contractor that does not have an obligation to contribute – i.e. is non-union – may, or may not, constitute a complete withdrawal from the plan.[8]

To qualify for the exemption, "substantially all" the employees with respect to whom the employer has an obligation to contribute under the plan perform work in the B&C industry.[9] The phrase substantially all is not defined in the regulations, although courts have typically applied 85%.

The Sheet Metal Workers National Pension Fund has criteria which it applies in determining whether an employer meets the B&C exemption. Under NPF's criteria 85% or more of the employees on whose behalf contributions were remitted must spend 25% or more of their time in the field. The "field" refers to work performed on a construction jobsite, as contrasted with work on a production or manufacturing shop floor.

With the breadth of the sheet metal industry and the different scopes of work contractors perform, clarifying what constitutes "construction work" or "jobsite work" is important. The PBGC has opined that the term "Building and Construction Industry" includes, but is not necessarily limited to, "work performed at the site of a building or other structure in connection with the erection, alteration of the building or other structure."[10]

For sheet metal contractors, the following serves as general guidance:

- Installation
  Contractors that perform exclusively installation meet the B&C exemption.

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[7] ERISA § 4203(b)

[8] *PBGC Op. Ltrs.* 85-5, 92-2; *H.C. Elliott, Inc. v. Carpenters Trust Fund,* 858 F.2d 808 (9thCir. 1988); *Oregon Washington Carpenters v. BQC Const., Inc.,* 485 F.Supp. 2d. 1206 (D. Ore. 2007).

[9] ERISA § 4203(b)(1)(A)

[10] PBGC Op. Ltr. 83-21

- Fabrication
  Contractors that exclusively fabricate material do not meet the B&C exemption.

- Mix of Installation and Fabrication
  Contractors which install and fabricate will need to analyze the man-hours in each to determine whether they meet the NPF's criteria.

- Service and Repair
  Service and repair work is not considered B&C industry work. Contractors that perform exclusively service work will not meet the B&C exemption; contractors which perform a mix of service and installation work will need to analyze the man-hours to determine whether they meet the NPF's criteria.

- Testing and Balancing
  TAB work, in many jurisdictions, falls under the building trades agreement, and is among the final phases on a construction project. The NPF has suggested that for these reasons it should be considered B&C industry work.

Again, a contractor that meets the B&C test and sells it assets, or otherwise ceases operations through a dissolution or liquidation, does not trigger withdrawal liability.

The caveat to this is the doctrine of successor liability. Several court decisions recently have found asset purchasers to be successors and liable for the predecessor seller's withdrawal liability.[11] Where there is uncertainty if a contractor meets the B&C exemption, or the assets will be sold to a non-union contractor, it is critical to involve ERISA counsel to carefully analyze the issues given the changing state of the law in this area.

II. ERISA § 4204 Sale of Assets

A non-B&C contractor who is going to cease contributing to a plan by reason of a sale of assets will trigger a withdrawal, but may avoid that liability by complying with § 4204 of ERISA. The parties to the transaction must inform the plan of the intent to comply with § 4204, and demonstrate to the satisfaction of the plan that the criteria are met.

A. <u>Requirements to Comply with § 4204</u>

[11] *Tsareff v. Manweb Services, Inc.*, 794 F.3d 841 (7th Cir. 2015); *Resilient Floor Covering Pension Trust Fund v. Michael's Floor Covering, Inc.*, 801 F.3d 1079 (9th Cir. 2015); *cert. denied*, 2016 U.S. LEXIS 3378 (May 23, 2016)

The § 4204 requirements that should be set forth in the asset purchase agreement are:

1. The purchaser must have an obligation to contribute to the plan for substantially the same number of contribution base units (CBUs) ;[12]

2. The purchaser must post a bond for 5 years,[13] unless one of the exceptions is met; and

3. The seller remains secondarily liable if the purchaser withdraws from the plan within 5 years of the sale and does not pay its withdrawal liability.[14]

Each of these warrants further discussion.

1. Substantially the Same Number of CBUs

The asset purchase agreement should recite that the buyer will continue to contribute substantially the same number of CBUs. The policy underlying this requirement is to protect the plan's funding base following a cessation of contributions by a withdrawing employer.

There are some differing views on how this provision is to be interpreted. Some arbitrators have suggested it is sufficient for the asset purchase agreement to create the obligation on the part of the buyer, without regard to whether the CBUs actually decline after the sale.[15] Other arbitrators have considered whether events following the sale that lead to the decline in contributions were normal or foreseeable.[16]

[12] ERISA § 4204(a)(1)(A)
[13] ERISA § 4204(a)(1)(B)
[14] ERISA § 4204(a)(1)(C)
[15] *Hoffman Mgt. Corp. and CTDU Pension Fund*, 11 EBC 1489 (Cornelius, Arb. 1989).
[16] *Dravo Corp. and IAM National Pension Fund*, 6 EBC 2641, 2652 (Mittleman, Arb. 1985); *Kroger Co. and Southern Cal. Food Workers Pension Fund,* 6 EBC 1345, 1364 (Nagle, Arb. 1985).

A circuit court has held that whether the requirement is met is judged at the time the asset purchase agreement is entered into; what occurred after the sale, and whether the purchaser fulfilled its obligations, is irrelevant.[17]

Another circuit court ruled that the "substantially the same" refers to the contribution base units, and where an asset purchase agreement only refers to the same contribution rate, and not the number of hours of employee pay, it failed to satisfy the requirements[18].

"Substantially the same" has been interpreted to mean 65%[19] and 85%.[20]

2. Purchaser's Bond Requirement

The purchaser is required to post a bond with the plan to guarantee both the payment of the buyer's potential withdrawal liability, and/or the payment of fringe benefit contributions, for 5 plan years.

The amount of the bond is the greater of: (1) the average annual contribution required to be made by the seller with respect to the operations under the plan for the three plan years preceding the plan year in which the sale of assets occurred; or (2) the annual contribution that the seller was required to make with respect to the operations under the plan for the last plan year before the plan year in which the sale of assets occurs.

There are 3 variances to this requirement:

The first is the *de minimis* transaction.[21] If the amount of the bond that would be required does not exceed the lesser of $250,000 or 2% of the average total contributions made by all employers to the plan for the 3 prior plan years, then the purchaser's bond requirement is waived.

For the NPF, the average total contributions for the 3 prior plan years (assuming a sale in the 2015 plan year) were $461,666,232; 2% of that is $7,233,324.63. Therefore in the case of the NPF, if the bond that would be required is less than $250,000, no bond is required.

[17] *Central States v. Cullum Companies, Inc.,* 973 F.2d 1333 (7th Cir. 1992).
[18] *HOP Energy, LLC v. Local 553 Pension Fund,* 678 F.3d 158 (2nd Cir. 2012)
[19] *Central States v. Cullum Companies, Inc.*, *supra.*
[20] *Consol. Enterprises and Western Conference of Teamsters Pension Fund*, 12 EBC 2078 (Slater, Arb. 1990).
[21] 29 C.F.R. § 4204.12

The second is the net income test.[22] If the purchaser's average net income for the 3 most recent fiscal years equals or exceeds 150% of the amount of bond that would be required, no bond is required.

The third is the net tangible assets test.[23] If the purchaser's net tangible assets at the end of the most recent fiscal year equals or exceeds: 1) if the purchaser was not previously required to contribute to the plan, the amount of UVBs allocated to the seller; or 2) if the purchaser was previously required to contribute to the plan, the amount of UVBs allocated to the purchaser and the seller, no bond is required.

The parties to the sale must inform the plan in writing of their intention that the sale be covered by § 4204 and demonstrate to the plan's satisfaction that one of the variances is satisfied.[24]

3. Seller's Secondary Liability

To protect the plan's ability to recover liability tied to the buyer's future withdrawal and inability to satisfy the liability, the seller must remain secondarily liable.

The asset purchase agreement must provide that if the purchaser withdraws during the five plan years following the sale, and the purchaser fails to make withdrawal liability payments when due, the seller will be secondarily liable to the plan.[25] The seller's liability is capped at the amount that seller would have been required to pay had it withdrawn at the time of sale.[26]

If all or substantially all of the seller's assets are sold in connection with the asset purchase agreement, or if the seller is liquidated before the end of the 5th plan year following the sale, then the seller is required to provide a bond equal to the amount of withdrawal liability it would have had at the time of the sale.[27] The plan can agree to waive this bond.[28]

B. Purchaser's Assumption of 5 Years of Buyer's Contribution History

[22] 29 C.F.R. § 4204.13(a)(1)
[23] 29 C.F.R. § 4204.13(a)(2)
[24] 29 C.F.R. § 4204.11(a)
[25] ERISA § 4204(a)(1)(C)
[26] ERISA § 4204(a)(2)(B)
[27] ERISA § 4204(a)(3)
[28] PBGC Multiemployer Bulletin (July 1, 1981)

When the parties comply with § 4204, the purchaser assumes the contribution history of the seller for the plan year of the sale, and the 4 preceding plan years.[29] That is, the purchaser's future liability, in the event it withdraws within 15 years of the sale, will be determined including the seller's contribution history for the 5 plan years. That is because the computation of withdrawal liability uses the 20 year contribution history. If, for example, the purchaser withdraws 25 years after the sale, the seller's CBUs would not be factored into the computation.

If the purchaser does not have its own contribution history – i.e. a non-signatory or non-contributing employer – then its initial liability to the plan will only be 5 years' worth of CBUs. This liability is obviously less (75% less) than the seller's would have been had it withdrawn.

On the other hand, if the purchaser has its own contribution history – i.e. a signatory, contributing employer – then the purchaser's CBUs are aggregated together with the seller's for the 5 plan years.

Of course, § 4204 and its requirements may bear upon the negotiations of the purchase price. Many purchasers of contractors in the union market are doing so purposefully; they want and intend to operate their companies as union signatory, contributing contractors and are looking to expand their operations. A buyer who is a signatory, contributing employer, will have its own withdrawal liability based on its own history, which will continue to grow in the future. By using § 4204, the buyer is only assuming a fraction (25%) of the seller's withdrawal liability, and over the long-term (20+ years) that assumed liability will no longer be computed in the purchaser's allocable share of the plan's unfunded vested benefits.

III. Limitation on Liability Without a § 4204 Sale

If a sale is not structured to comply with § 4204, or it cannot otherwise be utilized, § 4225 of ERISA limits the liability that can be assessed when a contractor ceases to contribute to the plan by reason of a sale of assets in an arms-length transaction to an unrelated party.

If the net amount received in the sale is less than $5 million, the liability that can be assessed against a seller is 40% of the net amount received.[30] If the net amount

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[29] ERISA § 4204(b)(1)

[30] ERISA § 4225(a)(1)

received is greater than $5 million, the statute provides for a scale where the 30% limitation gradually increases.[31]

Where the employer undergoing liquidation or dissolution is insolvent,[32] the liability which can be assessed is limited to half of the normal withdrawal liability, plus that portion of the second half that does not exceed the liquidation or dissolution value determined as of the beginning of the liquidation or dissolution.[33]

A contractor does not need to undergo a formal liquidation or dissolution in order to qualify for this relief, but it must be insolvent and wind up its business affairs[34]. Importantly, a Chapter 11 reorganization is not considered to be a liquidation or dissolution.[35]

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[31] ERISA § 4225(a)(2)

[32] An employer is deemed to be insolvent under the statute where its liabilities, including withdrawal liability under the plan exceed it assets.

[33] ERISA § 4225(b)

[34] Joint Explanation of S.1076: Multiemployer Pension Plan Amendments Act of 1980, Sec. 5b, 126 Cong.Rec. S.10117, 96th Cong. (2d Sess.) (Daily Ed., July 29, 1980)

[35] *Granada Wines, Inc. v. New England Teamsters Pension Fund*, 748 F.2d 42 (1st Cir. 1984)