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KIRKLAND **ALERT**

February 2015

Employee Benefits Update

- Changes to Multiemployer Pension Plan Liabilities
- New Plant-Shutdown Rules for Single Employer Pension Plans
- Supreme Court Eliminates Inference of Vesting for Retiree Health Benefits

Changes to Multiemployer Pension Plan Liabilities

Background. The December 2014 spending bill passed by Congress included the Multiemployer Pension Reform Act of 2014 ("Act"), which implemented many reforms sought by a joint labor-business commission. This commission issued a report in February 2013 titled *Solutions not Bailouts: A Comprehensive Plan from Business and Labor to Safeguard Multiemployer Retirement Security, Protect Taxpayers and Spur Economic Growth* ("Report"),[1] which recognized that the precarious financial state of many multiemployer plans and resulting specter of large potential withdrawal liabilities are a major impediment to multiemployer pension plans retaining existing contributing employers and attracting new ones. The Report recommended ways to strengthen the current multiemployer pension plan system and help deeply troubled plans to avoid insolvency, and those recommendations served as the basis for the Act.

Key Provisions. Although the Act includes many provisions of interest to pension professionals, this Alert highlights the changes that will be of most interest to investors in companies that have multiemployer pension plan obligations as well as those exploring restructuring opportunities for such companies. Of most importance in this context are new provisions allowing plans in the worst shape to reduce some benefits and to disregard certain contribution increases when calculating an employer's withdrawal liability.

- **Some Seriously Troubled Plans Can Now Cut Benefits, Including for Current Retirees**

Prior pension reform legislation required trustees of plans in "endangered" (generally less than 80% funded) or "critical" (generally less than 65% funded) status to increase employer contributions and reduce future benefit accruals and "adjustable" benefits not guaranteed by the PBGC.[2] Because of anti-cutback rules in ERISA and the IRC[3] a plan could not reduce accrued and vested normal retirement benefits unless the multiemployer plan became insolvent,[4] at which time benefits could be reduced to the level guaranteed by the PBGC.

The Act creates an exception to the anti-cutback rules and a process under which plan trustees are permitted to reduce certain accrued and vested normal retirement benefits before the plan becomes insolvent. While this provision has generated significant attention and controversy, it is quite limited in scope:

1. *Eligible Plans*. Only multiemployer pension plans designated in "critical and declining status" can reduce benefits. This applies if the plan's actuary certifies that the plan is in critical status and is either projected to become insolvent within 15 years or has a ratio of retirees (or other inactive participants) to active employees greater than 2:1 and is projected to become insolvent within 20 years.

2. *Voluntary Action by Trustees*. Benefit reductions under the Act can only occur if the trustees elect to take this action.[5] Given this dynamic (and some of the other conditions described below), benefit reductions should occur only in the most dire of circumstances to prevent otherwise inevitable plan insolvency.

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3. *Limits on Benefit Reductions*. The Act imposes a number of important limits on benefit reductions. For example:

    - The reductions in the aggregate must be reasonably estimated to achieve, and may not materially exceed, the level that is necessary for the plan to avoid insolvency.

    - Benefits cannot be reduced below 110% of the PBGC guarantee level and must be distributed equitably across all participants. The Act provides a number of factors for the trustees to consider in making this determination.

    - Benefits provided to retirees who are at least 80 years old or receiving benefits on account of disability cannot be reduced, and there is a progressive phase-out of the benefit reduction for retirees between the ages of 75 and 80.

4. *Process for Benefit Reductions, Including Participant Voting and Government Override*. Once the trustees make a decision to reduce benefits, there are a number of procedural hurdles to implementation:

    - If the plan has 10,000 or more participants, the trustees must appoint a plan participant as a retiree representative whose role is to advocate for the interests of terminated plan participants throughout the benefit reduction process.

    - Even if a plan is in critical and declining status, no benefit reductions can occur unless the plan's actuary certifies that the reductions are projected to enable the plan to avoid insolvency and the trustees have determined in writing that they have taken, and continue to take, all other reasonable measures to avoid insolvency.[6]

    - The trustees must submit an application to the Department of Treasury before implementing benefit reductions and provide notices to specified interested parties. Treasury must consult with the PBGC and Department of Labor ("DOL") before approving the application. The Act provides that the agencies must accept the trustees' determinations unless they are "clearly erroneous."

    - Once the trustees' application is approved by Treasury, the benefit reductions are subject to a vote of plan participants and beneficiaries. Benefit reductions will go into effect unless a majority of all participants and beneficiaries in the plan vote to reject the reductions.

    - If a majority of participants and beneficiaries vote against the benefit reductions, the reductions can still take effect if Treasury, in consultation with the PBGC and DOL, determines that the plan is "systemically important." A systemically important plan is one where the present value of projected PBGC assistance to the plan if the benefit reductions are not implemented would exceed $1 billion (indexed annually).

- **Employer Withdrawal Liability Calculations**

Withdrawal liability[7] is generally calculated based on the withdrawing employer's proportionate contributions to the plan over a specified period of time.[8] Existing ERISA provisions require trustees of plans in endangered or critical status to seek higher contribution rates from employers and impose a "surcharge" until the employer and union agree to the higher rates.

These rules could incentivize the bargaining parties to allow for an employer's withdrawal from the plan before the contribution increases take effect if the employer's annual withdrawal liability payments would be less than the annual contributions required for the employer to remain in the plan. To address this situation, the Act states that both the surcharges and higher contribution rates (for plan years beginning after December 31, 2014) that are required under a

multiemployer plan's "funding improvement" or "rehabilitation" plan are disregarded when allocating the plan's unfunded liabilities to an employer for withdrawal liability purposes and calculating the annual amount of the employer's withdrawal liability payments.

However, any benefit reductions implemented under the Act will have no immediate effect on the overall amount of the employer's withdrawal liability because the Act states that benefit reductions are not reflected in the employer's withdrawal liability unless the withdrawal occurs more than 10 years after the implementation of the benefit reductions.

- **Expanded PBGC Authority to Partition Plans or Facilitate Plan Mergers**

Under ERISA the PBGC can "partition" a troubled multiemployer plan, meaning the plan will be split into (1) a single employer pension plan that is treated as terminated and (2) a multiemployer plan that continues. Prior to the Act, partitioning only applied to separate off the portion of a seriously underfunded plan that was obligated to pay benefits earned with bankrupt employers from the part of the plan funded by non-bankrupt employers. The Act removes the bankruptcy requirement so that upon application from plan trustees, the PBGC can now partition a plan that is in "critical and declining status" if the PBGC determines that the partition is necessary to avoid plan insolvency and will reduce the PBGC's expected long-run loss related to the plan. Partitions have been extremely rare in the past but could now be used as a tool to restructure seriously underfunded plans that meet the new partition criteria.

The Act also permits the PBGC to facilitate a merger of different multiemployer plans, enabling the PBGC to provide technical assistance, mediation, communication with stakeholders, support with government filings, and financial assistance if necessary to avoid or postpone plan insolvency. Mergers must be initiated by the plan trustees, and likely would typically involve the merger of a weaker plan into a better funded one. However, the merger must not be reasonably expected to be adverse to the overall interests of the participants and beneficiaries of any of the merging plans, and thus mergers should result in a net strengthening of the multiemployer system.

New Plant-Shutdown Rules for Single Employer Pension Plans

Background. The spending bill also included reforms to the "plant-shutdown" rules applicable to single employer pension plans found in ERISA section 4062(e). These rules can impose funding liability[9] on the employer (and certain of its affiliates) prior to the plan's actual termination. Previously an employer triggered section 4062(e) liability when, as a result of a facility closing, more than 20% of the employees that participated in the pension plan lost their jobs (referred to generally as a "section 4062(e) event"). Prior law provided a formula for determining the amount of the liability, and allowed employers to satisfy the liability in various ways, including posting a bond or other security. In practice, the PBGC typically enforced this provision by negotiating settlements whereby the employer was required to make often substantial immediate additional cash contributions to its pension plan.

The PBGC interpreted section 4062(e) very broadly, and, in recent years, ramped up efforts to aggressively enforce this provision. Plan sponsors expressed concern that routine business decisions, such as the temporary shutdown of a facility for repairs or the sale of a business unit or facility, were being inappropriately considered as section 4062(e) events. These concerns were echoed by some in Congress and in response the PBGC announced a temporary enforcement moratorium in July 2014. The PBGC has now lifted this moratorium.

Key Provisions. The primary changes to ERISA section 4062(e), which apply to cessations of operations occurring on or after December 16, 2014,[10] are as follows:

1. *Triggering a Section 4062(e) Event*. An employer will generally trigger liability upon a permanent cessation of operations at a facility that results in a reduction of "eligible employees" of more than 15%. An "eligible employee"

is any employee who is eligible to participate in any employer-sponsored pension benefit plan, including a 401(k) plan. Because an employer's entire full-time workforce in the U.S. is typically eligible for at least a 401(k) plan, the focus is now on the percentage reduction in the total U.S. workforce caused by the employer's cessation of operations rather than the percentage reduction in each defined benefit pension plan.

- When calculating the 15% workforce reduction, employees of related entities that are part of a "controlled group" are included. Based on the PBGC's position that separate portfolio companies of the same private equity fund would often be in the same controlled group for ERISA purposes, such portfolio companies may be less likely to trigger liability under new ERISA section 4062(e).
- When computing the workforce reduction, the revised rules allow employees who have lost their jobs as a result of a facility closing to be disregarded for purposes of the 15% calculation if the employer replaces them with a U.S. citizen or resident at any employer facility in the U.S. within a reasonable amount of time.
- If a reduction in the employer's workforce occurs as a result of a stock or asset sale, the revised rules allow employees to be disregarded for purposes of the 15% calculation if the buyer (i) either employs or replaces the separated employee within a reasonable amount of time and (ii) assumes the portion of the assets and liabilities of the seller's pension plan attributable to the separated employee (i.e., accepts a pension spinoff).

2. *Small-Plan and Funding-Based Exemptions*. Plans with fewer than 100 participants and plans that were at least 90% funded (determined on a PBGC variable premium rate basis) in the plan year before the facility closing are both exempt from liability under ERISA section 4062(e).
3. *Satisfying Liability for a Section 4062(e) Event*. If a section 4062(e) event has occurred then liability will be determined on a plan-by-plan basis. For each plan affected, an employer may elect to satisfy the liability by making 7 additional annual contributions to the plan in an amount equal to 1/7 of the unfunded vested benefits (determined on a PBGC variable premium rate basis) multiplied by the percentage reduction in active participants. However, the employer may stop making the additional annual contributions if, at any time, the plan reaches a 90% funding level (as determined annually by the plan's actuary). Once the plan reaches this funding level, the employer is not required to restart contributions even if the plan later falls below the 90% threshold. On the other hand, if an employer makes a late payment or stops making payments, all remaining payments become accelerated.

Supreme Court Eliminates Inference of Vesting for Retiree Health Benefits

A recent U.S. Supreme Court decision could provide relief to employers, particularly those with operations in Michigan, Ohio, Tennessee and Kentucky, seeking to control their legacy welfare benefit costs. In *M&G Polymers USA, LLC v. Tackett*,[11] the Supreme Court held that retiree health benefits provided under collective bargaining agreements are not entitled to any special inference or presumption of vesting. In so holding, the Supreme Court resolved a long-standing circuit split and overruled the Sixth Circuit's decades-old decision in *International Union, United Auto, Aerospace & Agricultural Implement Workers of America v. Yard-Man, Inc.*,[12] which had placed "a thumb on the scale in favor of vested retiree benefits" when interpreting collective bargaining agreements.[13]

Background. Unlike pension benefits, which typically must become vested (i.e., cannot be forfeited, reduced, or eliminated) after certain periods of time, employers have broad discretion to modify welfare benefits such as health and life insurance. Employers are generally free to adjust contribution and benefit levels, or to cease providing welfare benefits entirely, unless the employer has made a contractual commitment to the contrary. Such contractual commitments can take the form of plan documents, individual employment agreements or collective bargaining agreements.

Welfare benefits for retirees are often defined by the terms of a collective bargaining agreement, which may or may not specify the duration of such benefits. Most courts have taken the position that retiree health benefit provisions do not last beyond the term of the applicable collective bargaining agreement unless there is specific language or evidence to the contrary. The Sixth Circuit has taken the opposite approach, inferring that retiree health benefits provided under collective bargaining agreements are intended to be guaranteed for life unless there is specific language limiting the duration of such benefits.

The Supreme Court's Decision. In a unanimous decision, the Supreme Court reversed the Sixth Circuit's holding that an inference in favor of vesting applied to retiree welfare benefits under a collective bargaining agreement in the absence of extrinsic evidence to the contrary. The Supreme Court held that collective bargaining agreements, including those describing retiree health benefits, must be interpreted according to ordinary principles of contract interpretation, including that (1) contractual obligations will cease upon termination of the bargaining agreement unless the agreement provides in explicit terms that certain benefits continue after the agreement expires and (2) a contractual provision that is silent as to its duration should not be construed to create lifetime obligations.

Implication. Because of the Sixth Circuit's inference of vesting, the outcome of retiree health benefit litigation has often depended upon the forum of litigation as much as the language of the collective bargaining agreement. The Supreme Court's decision in *Tackett* is an important step toward uniformity in analyzing whether retiree health benefits are vested under a collective bargaining agreement. However, even after *Tackett*, collective bargaining agreements that are ambiguous regarding the intended duration of such benefits still present risks to the employer. When the language is ambiguous as to the vesting of retiree welfare benefits, the parties often must pore through decades of collective bargaining agreements, plan documents, and participant communications for evidence of the parties' intent with respect to the duration of benefits. Although bargaining dynamics may make this difficult, it is advisable that retiree health benefit provisions in collective bargaining agreements contain explicit durational clauses or clear reservations of the employer's unilateral rights to modify or terminate such benefits.

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[1] The Retirement Security Review Commission of the National Coordinating Committee for Multiemployer Plans. Report available at http://webiva-downton.s3.amazonaws.com/71/59/b/39/1/Solutions_Not_Bailouts.pdf.

[2] Adjustable benefits include early retirement benefits, post-retirement death benefits, and certain disability benefits. "PBGC" is the Pension Benefit Guaranty Corporation, the federal agency that regulates and insures private pension plans. In the context of the new rules it is important to note that obligations of the PBGC are not obligations of the federal government. *See* ERISA 4002(g)(2) ("The United States is not liable for any obligation or liability incurred by the [PBGC].") The PBGC's plan insurance program is funded only with premiums paid by plan sponsors and investment earnings on assets controlled by the PBGC. A PBGC annual report showed a $42.4 billion deficit in its multiemployer pension guarantee fund as of September 30, 2014, and notes that the PBGC expects insolvency of a number of large multiemployer pension plans to occur in the next decade for which assets from the PBGC will not be available to pay guaranteed benefits. *PBGC Annual Report, Fiscal Year 2014* available at: http://www.pbgc.gov/documents/2014-annual-report.pdf. The Act doubled the premiums that a multiemployer plan owes to the PBGC to $26 per participant starting in 2015 and provides for automatic indexing of those amounts.

[3] "ERISA" is the Employee Retirement Income Security Act of 1974, as amended; "IRC" is the Internal Revenue Code of 1986, as amended.

[4] In certain cases, normal retirement benefits resulting from benefit increases adopted within 5 years could be reduced.

[5] The trustees can also decide whether benefit reductions under the Act will be temporary or permanent. The Act includes a provision purportedly shielding the trustees and government agencies from participant lawsuits in connection with these benefit reductions.

[6] The factors the trustees can use to make this determination include contribution levels (and the impact of higher contribution levels on retaining employers in the plan), level of benefit accruals and prior reductions in the rate of benefit accruals or adjustable benefits, competitive and other factors facing the contributing employers, and other measures taken to retain or attract contributing employers.

[7] Withdrawal liability is an employer's share of a multiemployer plan's overall unfunded benefit liabilities that is imposed at the time the employer withdraws from the plan. A withdrawal can occur when the employer sells its assets, shuts down a facility, terminates a significant number of its union-represented employees or otherwise ceases to have or substantially reduces its obligation to contribute to the plan.

[8] Under ERISA withdrawal liability payments are usually capped at 20 years of payment of an amount determined by reference to the employer's prior contributions to the plan, though the 20-year cap does not apply in the event of the employer's bankruptcy, its default on an installment payment, for certain other employer default events, or if the plan terminates by "mass withdrawal." A mass withdrawal occurs when all or substantially all employers withdraw from the plan and could be initiated by the plan trustees or the employers.

[9] The liability imposed is a portion of the plan's unfunded benefit liabilities calculated on a plan termination basis, which is typically much higher than the liability on an ongoing basis due to the actuarial assumptions that must be utilized for plan terminations.

[10] The PBGC must apply the new rules to prior cessations, except where a settlement was entered into before June 1, 2014.

[11] No. 13-1010, slip op. (Jan. 26, 2015), *available at* http://www.supremecourt.gov/opinions/14pdf/13-1010_7k47.pdf.

[12] 716 F.2d 1476 (6th Cir. 1983).

[13] *Tackett*, slip. op. at 10.

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