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Management Alert

PBGC Proposed Regulations – Withdrawal Liability

The Pension Benefit Guaranty Corporation (PBGC) has issued proposed regulations that would make certain modifications to ERISA's multiemployer pension plan withdrawal liability rules. These new rules could, in some cases, dramatically alter the amount of withdrawal liability that would otherwise be assessed to an employer withdrawing from a multiemployer pension plan. The proposed regulations, which primarily reflect statutory changes made by the Pension Protection Act of 2006 (PPA), address (1) the PPA's new "fresh start" rule, (2) mandated adjustments to the withdrawal liability calculation for multiemployer plans that are in "critical status," (3) the PPA's limited exception that allows an employer to delay making withdrawal liability payments until a final decision is rendered by a court or arbitrator, and (4) the allocation of a plan's total unfunded vested benefits (UVBs) among employers in a mass withdrawal. The proposed regulations also modify the definition of "multiemployer plan."

New "Fresh Start" Rule

An employer that completely or partially withdraws from a multiemployer pension plan is subject to liability for its share of unfunded vested benefits. ERISA provides alternative methods for calculating the amount of an employer's withdrawal liability, the most common of which are known as the "presumptive method" and the "modified presumptive method." For both methods, the first step is to calculate the plan's UVBs prior to 1980, and then allocate those UVBs to those employers contributing at that time. The employer's allocable share of UVBs is generally determined by dividing the contributions paid by the employer over a set period of time by contributions paid by all employers over the same time period. Once the employer's share of pre-1980 UVBs is determined, this amount is added to withdrawal liability incurred after 1980. Under the presumptive method, for years after 1980, an employer is allocated a share of the change in UVBs on a year-by-year basis. Under the modified presumptive method, an employer is allocated a share of total UVBs that exist in a year prior to the year of withdrawal.

The new proposed regulations allow a plan to substitute any year for the previously prescribed 1980 cutoff, thus providing a "fresh start" year. According to the PBGC, the intent of the new rule is (1) to relieve plans using the presumptive method from the burden of having to go back as far as 1980 to compute each employer's allocable share of changes in UVBs, and (2) to provide relief to new employers from liability for past UVBs. Thus, for a plan using the presumptive method, if the plan was not fully funded for the designated year, the UVBs in existence during the designated year would be allocated among the then- contributing employers (and the plan would not have to go back to 1980, allocating UVBs

on a year-by-year basis). In addition, whether a plan used the presumptive method or the modified presumptive method, if the plan designated a year where there were no unfunded benefits, employers withdrawing from the plan after such designation was made would not be liable for UVBs that developed in years prior to the designated year.

Note that construction industry plans are required to use the presumptive method, but, under the regulations (due to certain other restrictions), may only designate a year in which the plan was fully funded as the new "fresh start" year.

The proposed rule clarifies that a plan's UVBs, determined with respect to plan years ending after the newly designated plan year, are reduced by the value of the outstanding claims for withdrawal liability that can reasonably be expected to be collected from employers who withdrew from the plan in or before the designated plan year.

The change allowing a plan using the presumptive method to designate a new fresh start year is generally effective January 1, 2007 (provided the new year is a year in which the plan is fully funded). The other changes generally are effective for employer withdrawals that occur on or after the effective date of the final rule.

Withdrawal Liability Calculations for Critical Status Plans

The PPA also introduced new rules for multiemployer plans whose funding is in "critical status." The new rule allows such plans to: (1) reduce "adjustable benefits" (*e.g.* post-retirement death benefits, disability benefits not yet in pay status, certain early retirement benefits, and retirement-type subsidies), and (2) subject contributing employers to a surcharge equal to 5% of contributions (10% after the first year the plan is in critical status). The PPA also provides that (1) such benefit adjustments are disregarded in determining a plan's UVBs, and (2) the employer surcharge is not taken into account in calculating an employer's allocable portion of UVBs for purposes of determining withdrawal liability. The proposed rule expands the definition of "nonforfeitable benefits" and "unfunded vested benefits" to include adjustable benefits that have been reduced while the plan is in critical status. The proposed rule also provides that the employer surcharge would be subtracted from both the numerator and denominator of the allocation fraction (*i.e.,* the ratio of an employer's contributions to total contributions) used to determine an employer's withdrawal liability. These changes are effective for withdrawals occurring during plan years beginning on or after January 1, 2008.

Relief from Interim Withdrawal Liability Payments

An employer is generally required to make withdrawal liability payments even if the employer is contesting the withdrawal liability assessment. The PPA created an exception to this rule in cases where a plan sponsor makes a determination that the employer's withdrawal liability was due to a transaction whose purpose was to evade or avoid withdrawal liability. The proposed regulation implements this exception. Under the proposed regulation, an employer will be relieved of its obligation to pay withdrawal liability until a final decision is reached by an arbitrator or court if (1) the alleged transaction occurred on or after December 31, 1998, and at least five years prior to the withdrawal (two years for small employers), and (2) the employer provides notice to the plan sponsor of its election not to make the withdrawal liability payments. In addition, an employer is required to post a bond equal to the withdrawal liability payments that would otherwise be due if a court or arbitrator has not rendered a final decision within 12 months. This provision is effective for withdrawal liability assessments on or after August 17, 2006.

Reallocation Liability in Mass Withdrawal

Special withdrawal liability rules apply when a multiemployer plan terminates due to a "mass withdrawal." Generally, a mass withdrawal occurs when every employer withdraws from the plan, or when substantially all employers withdraw pursuant to an agreement or arrangement to withdraw. Under PBGC rules, a mass withdrawal can occur over a number of years. Employers do not have to withdraw in a single year for a mass withdrawal to occur. When a mass withdrawal is deemed to have occurred, an employer incurs "initial withdrawal liability," that is, liability for the employer's share of UVB determined at the time the employer withdrew plus "reallocation liability." In general, "reallocation liability" is the employers share of any remaining UVBs that, for example, are uncollectible from other employers. The amount of an employer's reallocation liability is based on its proportion of initial withdrawal liability relative to the initial withdrawal liability of all the other employers who are part of the mass withdrawal. Thus, an employer which is deemed to be part of a mass withdrawal but who withdrew in a year where there the plan had little or no unfunded liability, could be assessed a much lower portion of reallocation liability. The rule proposes to address this situation by using the employer's relative share of contributions for the three-year period preceding the mass withdrawal (rather than its share of withdrawal liability at the time it withdrew) to determine its reallocation liability. This provision will apply to mass withdrawals that occur after the effective date of the final rule.

Definition of Multiemployer Plan

The PPA amended the definition of a "multiemployer plan" to allow certain collectively bargained plans maintained by tax-exempt organizations to be treated as multiemployer plans. The election to be treated as multiemployer plans must be have been made by August 17, 2007. The proposed rule reflects this new definition of a "multiemployer plan."

Implications for Employers

Under the PPA, multiemployer pension plans are required to provide employers, upon request, with certain actuarial reports and other financial information. These plans also are required to provide employers with such information in the event the plan's funding status is "endangered" or "critical." These added disclosure requirements mean that employers will have a better ability to monitor the financial health of the plans in which they participate. If a multiemployer plan is poorly funded, a participating employer should ascertain (1) whether the plan has adopted a "fresh start" year, and (2) if so, the effect that this change (as well as the other changes described above) will have on the employer's withdrawal liability. It is particularly important for employers who withdraw from multiemployer pension funds after PPA certifications to request actuarial information that will allow a careful review of the actuarial assumptions and methods used to compute the withdrawal liability. It is likely that many of the plans have changed actuarial assumptions in anticipation of PPA certifications, and those changes may present an opportunity for a challenge to a withdrawal liability assessment, if they are not well-supported by the fund.

The PBGC invites comments on the new proposed regulations by May 19, 2008.

If you have any questions regarding this Management Alert, please contact the Seyfarth Shaw attorney with whom you work, or any Employee Benefits attorney on our website, www.seyfarth.com.

ATLANTA
One Peachtree Pointe
1545 Peachtree Street, N.E.
Suite 700
Atlanta, GA 30309-2401
404-885-1500
404-892-7056 fax

BOSTON
World Trade Center East
Two Seaport Lane
Suite 300
Boston, MA 02210-2028
617-946-4800
617-946-4801 fax

CHICAGO
131 South Dearborn Street
Suite 2400
Chicago, IL 60603-5577
312-460-5000
312-460-7000 fax

HOUSTON
700 Louisiana Street
Suite 3700
Houston, TX 77002-2797
713-225-2300
713-225-2340 fax

LOS ANGELES
One Century Plaza, Suite 3300
2029 Century Park East
Los Angeles, CA 90067-3063
310-277-7200
310-201-5219 fax

NEW YORK
620 8th Avenue
32nd Floor
New York, NY 10018
212-218-5500
212-218-5526 fax

SACRAMENTO
400 Capitol Mall
Suite 2350
Sacramento, CA 95814-4428
916-448-0159
916-558-4839 fax

SAN FRANCISCO
560 Mission Street
Suite 3100
San Francisco, CA 94105-2930
415-397-2823
415-397-8549 fax

WASHINGTON, D.C.
815 Connecticut Avenue, N.W.
Suite 500
Washington, D.C. 20006-4004
202-463-2400
202-828-5393 fax

BRUSSELS
Boulevard du Souverain 280
1160 Brussels, Belgium
(32) (2) 647 60 25
(32) (2) 640 70 71 fax

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