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Options for Troubled Multiemployer Pension Plans in a Post-PPA World

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Over the past two years, multiemployer pension plans have been challenged from two directions — they have had to learn to function under a very different set of funding rules under the Pension Protection Act of 2006 (PPA)[i] while grappling with sharp investment losses and a severe economic slowdown. As a consequence, many trustees find themselves fighting an uphill battle to stabilize their multiemployer plans. This article focuses on the tools available to address the serious financial problems facing multiemployer pension plans now.

Background

Throughout the 1990s, strong equity markets boosted the value of pension plan assets. Asset growth, coupled with robust employment that generated ample contributions, permitted (and often forced) plan trustees to improve benefits frequently. However, in the early 2000s, a substantial decline in equity values was brought on by the burst of the tech bubble and the attacks of September 11. Multiemployer plan trustees saw the value of their plan assets shrink over a two- to three-year period, in some cases covered employment dropped off, and many plans experienced underfunding. Mature plans were hit particularly hard because of their heavy reliance on investment returns to augment contributions.

Hoping to moderate this boom-and-bust cycle for plans and stave off similar crises in the future, Congress began work on comprehensive funding reform. This culminated in enactment of the PPA, in August 2006. For multiemployer plans, PPA tightened the funding rules for defined

benefit pension plans and instituted a comprehensive regime that compels trustees, employers and unions to take an active, forward-looking approach to management of their plans, and to identify and address financial problems as they emerge, before they ripen into full-blown crises. Then, shortly after the new PPA funding provisions took effect in 2008, the U.S. economy slumped, starting with the collapse of the sub-prime mortgage industry. As the markets dropped precipitously, multiemployer plan trustees once again saw their plans' asset values contract. As a result, multiemployer plans that were in sound financial health before the economic collapse are now facing funding shortfalls that are often severe.

Despite all this bad news, there is some modest reason for hope — the funding rules under PPA and other available mechanisms under the Employee Retirement Income Security Act (ERISA) give multiemployer plan trustees a number of statutory tools they can use to address the plan funding problems.

Addressing Funding Problems under the PPA

The PPA's funding rules use a "carrot and stick" approach to encourage trustees, employers and unions to address troubled plans' funding problems. The options available depend largely on whether a plan is in "endangered status," commonly referred to as in the "yellow zone"[ii] (*i.e.*, either less than 80 percent funded or has a projected accumulated funding deficiency within seven years), or in "critical status," commonly referred to as in the "red zone" (*i.e.*, generally, is projected either to be unable to pay benefits within five to seven years or to experience an accumulated funding deficiency within four to five years). Although different stakeholders may see different advantages for a given plan to be in one zone or the other, in general, trustees of plans in the red zone typically have more flexibility to address their plans' funding problems.

- ***Red Zone.*** The trustees of a plan in the red zone must adopt a "rehabilitation plan" that will allow the plan to emerge from critical status generally by the end of a 10-year period that starts within a year or two after the plan went into the red zone.[iii] The rehabilitation plan must

include one or more schedules designed to bring the plan's assets and liabilities into balance by cutting benefits, increasing contributions or both, to be included in the next labor contracts after the agreements that were in effect at the time the plan entered critical status expire.[iv] Employers in plans that adopt and comply with a rehabilitation plan schedule are protected from funding-related excise taxes and other penalties when there is a deficiency.[v] Additionally, if the bargaining parties fail to agree on a trustee-approved contribution schedule, they are treated as having agreed to a default schedule that may compel substantial benefit reductions and contribution increases as needed to meet the recovery goals of the rehabilitation plan.[vi] Until an employer agrees to a collective bargaining agreement (CBA) that includes an acceptable schedule of contributions, it is also assessed a five percent contribution surcharge, which escalates to 10 percent at the start of the next plan year.[vii] The threat of the surcharges can act as an incentive for employers to negotiate over a trustee-prescribed schedule.

Under PPA, the trustees of a plan in the red zone also have the unique ability to cut certain "adjustable benefits." These include post-retirement death benefits, 60-month guarantees and other subsidized optional payment forms, disability benefits not yet in pay status, early retirement benefits or retirement subsidies and benefit increases adopted less than 60 months before the plan went into the red zone (these recent benefit increases would not be eligible for a Pension Benefit Guarantee Corporation (PBGC) guarantee if the plan were insolvent).[viii] Reductions to adjustable benefits generally may not reduce the level of a participant's accrued benefit payable at normal retirement age. A plan must give 30 days advance notice of a red-zone benefit reduction.[ix] Except for the possible rollback of recent benefit increases, red zone plans may not reduce the benefits of anyone who retired before the plan notified participants and beneficiaries that the actuary had determined that it was in the red zone.

- ***Yellow Zone.*** Similar to red zone rules, the trustees of a yellow zone plan must institute a funding improvement plan (FIP) that takes actions reasonably likely to achieve a one-third

reduction in the underfunded level (as a percentage of the accrued benefit liability) and forestall a funding deficiency over a 10-year period.[x] For some plans, called “seriously endangered,” the goal is a 20 percent reduction in underfunding, to be achieved over 15 years. Like the red zone rehabilitation plan, a FIP must include schedules of contribution rates and related benefit modifications, and if the employers and unions cannot agree on a schedule, the trustees must impose a default schedule. Unlike red zone plans, however, trustees of plans in the yellow zone do not have the ability to cut adjustable benefits or assess employer surcharges. Additionally, there is no relief from excise taxes if the plan has a funding deficiency, though that would become available if the plan drifts into the red zone, which would happen automatically if a funding deficiency becomes imminent.

Addressing Funding Problems Using Creative Non-PPA Tools

In addition to the PPA's funding rules and such traditional measures as amortization extensions, trustees of plans with dire financial problems may also seek to utilize other available tools, including (a) "managed" mass withdrawal, (b) partition, (c) merger and/or (d) alternative contribution arrangement. Each of these options is discussed below.

- ***Managed mass withdrawal.*** If a troubled plan cannot adequately address its funding problems, the bargaining parties may, as a practical matter, conclude that they have no option but to freeze the plan and allow the employers to withdraw from it. ERISA provides for termination of a multiemployer plan by withdrawal of every employer from the plan or cessation of every employer's obligation to contribute (*i.e.* a "mass withdrawal").[xi] Employers who are part of a mass withdrawal would owe statutory withdrawal liability based on an employer's *pro rata* share of the plan's unfunded vested benefits, computed using conservative assumptions prescribed by the PBGC.

  Some employers facing mass withdrawal liability obligations may have difficulty obtaining credit and may, as a consequence, be forced to file for bankruptcy. Significantly, the withdrawal liability of employers in bankruptcy can roll over to other employers, which can

lead to additional bankruptcy filings or employer liquidations, greatly limiting the plan's collections. To avoid these possible consequences, some troubled plans, working with the bargaining parties, have undertaken a "managed" mass withdrawal. This process involves approval by the PBGC of alternative rules rather than the standard mass withdrawal liability rules provided under the statute.[xii] As part of the process of gaining PBGC approval of alternative payment rules and ensuring that a troubled plan is protected, the plan would need to verify that use of alternative payment rules would not adversely affect the plan. This would require an independent financial analysis to show that the total amounts collected over time under the alternative rules will equal or exceed the amounts that are likely to be recovered by that plan by applying the statutory payment rules that otherwise apply.

- ***Plan partition.*** ERISA allows a plan partition as a type of "surgery" to save a plan that would otherwise face daunting funding requirements as a result of employer bankruptcies. The basic premise of a plan partition is that the PBGC can remove certain liabilities from a plan for participants whose service is "directly attributable" to bankrupt employers if that would enable healthy employers to maintain the remainder of the plan. Once severed from the remaining plan, those liabilities are assumed by the PBGC and contributing employers are no longer responsible for them.[xiii]

  Multiemployer plans seeking a partition must apply to the PBGC, which may order a partition if it determines (among other things) that (1) a substantial reduction in the amount of aggregate contributions under the plan has resulted or will result from employer bankruptcies, (2) the plan is likely to become insolvent, (3) contributions will have to be increased significantly to meet the minimum contribution requirement and prevent insolvency, and (4) partition would significantly reduce the likelihood that the plan will become insolvent.[xiv]

- ***Merger with contingent spinoff /merger.*** Another option for a troubled plan is to seek to merge with a better-funded plan. In a few cases, the PBGC has provided assistance to help facilitate a merger. Such mergers have been structured to provide that the merged plan keep a

separate account of the assets and liabilities of the troubled plan. If the troubled plan portion of the merged plan becomes insolvent, the merged plan would be allowed to spin off unfunded guaranteed benefits attributable to the troubled plan at the time of the merger. At the time of that spinoff, the PBGC would pay a lump sum payment to cover the unfunded guaranteed benefits of the troubled plan. The troubled plan would then merge back into its merger partner on a fully integrated basis.[xv]

- ***Alternative contribution arrangement.*** An increasingly popular solution for troubled plans whose employers are running short of cash is for the trustees to agree to accept limited in-kind contributions. Although ERISA generally prohibits non-cash contributions, there is a statutory exemption for contributions in the form of employer securities and employer real property and the Department of Labor has granted individual exemptions for specific in-kind contributions.[xvi]

WRERA and Beyond

As a result of the global economic crisis, there has been a renewed call for pension funding reform. Consequently, late last year, Congress passed the Worker, Retiree, and Employer Recovery Act of 2008 (WRERA). In addition to making several technical corrections to PPA, WRERA allowed multiemployer plan trustees to "freeze" a plan's zone status temporarily (for one year) or to elect to extend the FIP or rehabilitation plan period by three years.[xvii]

Although WRERA has provided temporary relief, some believe that the zone freeze under the law has served merely to "kick the can" down the road in hopes that the economy will rebound. Since it appears the economy is unlikely to recover quickly, there could be a strong push for Congress to adopt meaningful pension funding reform. Multiemployer plans would be well advised to keep apprised as these legislative developments unfold on Capitol Hill.

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[i] Pub. L. No. 109-280.
[ii] ERISA § 305(b), 29 U.S.C § 1085(b).
[iii] ERISA §§ 305(e)(1), (3), 29 U.S.C § 1085(e)(1), (3). Congress recently passed the Worker, Retiree, and Employer Recovery Act of 2008 ("WRERA") that, among other things, allows multiemployer plans that are red-zone plans to elect to extend the rehabilitation plan period by three years.
[iv] *Id.*
[v] 26 U.S.C. § 4971(g)(4).
[vi] ERISA §§ 305(e)(1)(B), (3)(c), 29 U.S.C §§ 1085(e)(1)(B), (3)(c).
[vii] ERISA § 305(e)(7), 29 U.S.C § 1085(e)(7).
[viii] ERISA § 305(e)(8)(A)(i), 29 U.S.C § 1085(e)(8)(A)(i).
[ix] ERISA § 305(e)(8)(A)-(C), 29 U.S.C § 1085(e)(8)(A)-(C).
[x] ERISA § 305(c), 29 U.S.C § 1085(c). WRERA also permits multiemployer plans that are yellow zone plans to elect to add an additional three years to the funding improvement period.
[xi] ERISA § 4041A(a)(2), 29 U.S.C § 1341A(a)
[xii] ERISA § 4224, 29 U.S.C. § 1404.
[xiii] ERISA § 4233, 29 U.S.C § 1413.
[xiv] ERISA §§ 4233(a), (b), 29 U.S.C §§ 1413(a), (b).
[xv] *See* ERISA § 4231, 29 U.S.C § 1411; 29 C.F.R. § 4231.1, *et. seq.*
[xvi] 29 C.F.R. § 2509.94-3; ERISA §§ 407, 408(a), 29 U.S.C §§ 1107, 1108(a).
[xvii] Pub. L. No. 110-458.