Legal Update Article

'Segal Blend' Withdrawal Liability Calculation Violates ERISA, Court Holds in Milestone Decision

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The use of the "Segal Blend" to calculate a company's withdrawal liability when it withdrew from a multiemployer pension plan violated the Employee Retirement Income Security Act (ERISA), as amended by the Multiemployer Pension Plan Amendments Act (MPPAA), because it was not the actuary's best estimate, the federal appeals court in Cincinnati has held in a milestone decision for employers with withdrawal liability exposure. *Sofco Erectors, Inc. v. Trustees Ohio Operating Eng'r, et al.*, Nos. 20-3639/3671 (6th Cir. Sept. 28, 2021).

Sofco is the first time a Circuit Court decided whether the use of the Segal Blend to calculate employer withdrawal liability satisfied the applicable statutory mandate that the calculation represent "the actuary's best estimate of anticipated experience under the plan."

The Sixth Circuit has jurisdiction over Kentucky, Michigan, Ohio, and Tennessee.

Sofco was represented by Gary Greenberg of Jackson Lewis.

Withdrawal Liability and Segal Blend Calculation

Withdrawal liability is a statutory obligation that is triggered when an employer's collectively bargained obligation to contribute to a multiemployer pension plan (MEPP) ceases in whole or in part (*e.g.,* when they completely or partially withdraw). The amount of an employer's withdrawal liability represents the employer's allocable share of the MEPP's unfunded vested benefits (UVB). UVB represents the excess of liabilities over assets. Since liabilities represent obligations to make payments beginning at some future date (*e.g.,* when a participant retires), they must be discounted back to present value using an interest rate determined by the actuary.

This withdrawal liability interest-rate assumption is the most critical factor in the withdrawal liability calculation. The lower the interest rate, the greater the amount of withdrawal liability that is assessed on withdrawn employers. For this reason, MEPPs are incentivized to use lower rates when calculating withdrawal liability.

The Segal Blend is a proprietary actuarial technique developed and primarily used by actuaries employed by The Segal Group, Inc.; it has been used by hundreds of plans in thousands of withdrawal liability calculations. The Segal Blend generates the withdrawal liability interest rate by blending two rates: the rate used by the actuary for minimum funding purposes and lower rates published periodically by the Pension Benefit Guaranty Corporation (PBGC) for the purchase of annuities by MEPPs that terminate through a mass withdrawal (PBGC Rate).

Interestingly, MEPPs use different rates for different purposes. The fund actuary also must select an interest rate for purposes of determining whether the MEPP satisfies certain minimum funding requirements. A higher funding interest rate makes it easier for a MEPP to satisfy these requirements.

Case Background

In *Sofco*, the actuary for the Ohio Operating Engineers Pension Fund used a 7.25% funding interest rate before using the lower Segal Blend rate for withdrawal liability purposes. This rate discrepancy is at the heart of *Sofco*.

Sofco Erectors, Inc. is a construction company with bargaining unit employees in several trades. Its collective bargaining agreement (CBA) with Local 18 of the International Union of Operating Engineers obligated it to contribute to the Fund. As a MEPP, the Fund is subject to the withdrawal liability rules enacted as the MPPAA and codified in Title IV of ERISA.

When Sofco terminated its CBA with Local 18 in 2017, the Fund assessed the company withdrawal liability that was calculated using the Segal Blend. Sofco demanded arbitration. It argued in arbitration that the Fund's use of the Segal Blend to calculate its withdrawal liability violated MPPAA. (As the Sixth Circuit noted, had the Fund used the 7.25% funding interest rate, Sofco's withdrawal liability would be near zero.) After the arbitrator ruled in favor of the Fund, Sofco filed suit in the U.S. District Court for the Southern District of Ohio seeking to vacate the arbitral award.

The district court overturned the arbitrator's award. It saw the case as a straightforward matter of statutory construction. The basis for the district court's holding was Section 4213(a)(1) of ERISA (29 U.S.C. § 1393(a)(1)). That section requires withdrawal liability to be determined using "actuarial assumptions and methods which, in the aggregate, are reasonable (taking into account the experience of the plan and reasonable expectations) and which, in combination, *offer the actuary's best estimate of anticipated experience under the plan*." (Emphasis added.) The district court found the proper "inquiry returns to what the statute states it requires for an applicable return rate: what is the best estimate of the 'anticipated experience' under the plan."

The Fund actuary testified that the 7.25% funding interest rate was based upon "a review of past experience and future expectations taking into account the plan's asset allocation and expected returns." Therefore, the district court had little trouble holding the Fund's use of the Segal Blend violated the "best estimate of anticipated experience" requirement.

Sixth Circuit Decision

On appeal, the Sixth Circuit Court upheld the lower court, agreeing that the Fund's use of the Segal Blend violated Section 4213(a)(1) of ERISA. It ruled:

> Using the Segal Blend here violates the statute because the resulting interest rate is not "the actuary's best estimate of anticipated experience under the plan." *Id. § 1393(a)(1).* Rather, it dilutes the actuary's best estimate with rates on investments that the plan is not required to and might never buy, based on a set formula that is not tailored to "the unique characteristics of the plan."

The Fund argued unsuccessfully that the Segal Blend complied with the statute's best estimate requirement. The Court rejected this attempt to shift the risk (associated with anticipated investment returns) to the withdrawing employer. The Court stated, "An actuary using the Segal Blend is factoring in an interest rate used for plans that essentially go out of business [referring to the PBGC Rate], even though these plans are neither going out of business nor required to purchase annuities to cover the departing employer's share of vested benefits."

The Court had little trouble disposing of the Fund-proffered rationale that the assessment and payment of withdrawal liability represent a settlement and, according to the actuary's testimony, that "the way you settle up a multiemployer pension plan is by using those—is by doing an annuity purchase on behalf of all the participants, and the interest rates published by PBGC approximate annuity purchase rates." The Court was not persuaded. It compared the argument to "considering a hypothetical mass withdrawal, rather than the 'anticipated experience under the plan'" and "by looking to assets that the fund has not indicated it will ever purchase, rather than the fund's actual portfolio." This, the Court found, did not override clear and unambiguous statutory language.

The Court affirmed the holding below mandating that the Fund recalculate Sofco's withdrawal liability based on the 7.25% funding interest rate and adjust any payments and refunds due accordingly, with interest.

Implications; Questions

While the Fund may petition the U.S. Supreme Court for review, acceptance is unlikely in the current absence of a circuit court split.

The PBGC may assert itself as to future withdrawals. The statute authorizes the PBGC to "prescribe by regulation actuarial assumptions which may be used by a plan actuary in determining the unfunded vested benefits of a plan for purposes of determining an employer's withdrawal liability under this part." ERISA Section 4213(a). Many MEPPs certainly hope for such regulations — so long as such guidance produces higher withdrawal liability amounts. The PBGC has announced it "intends to propose a separate rule of general applicability under section 4213(a) of ERISA to prescribe actuarial assumptions which may be used by a plan actuary in determining an employer's withdrawal liability." Judge Joan Larsen acknowledged this in *Sofco*. She noted in a footnote, "We presume that the PBGC may displace § 1393(a)(1)'s requirements by regulation." Any proposed regulation on this issue is expected to be met with scrutiny from both MEPPs and employers.

Other questions remain unanswered as well. Many MEPPs use the applicable PBGC Rate to calculate withdrawal liability (without blending with the funding interest rate, as with the Segal Blend). Use of the PBGC Rate (currently, 2.4%) produces even more egregious results in the form of grossly inflated withdrawal liability when compared to the funding interest rate (generally, 6%-7.5% for most MEPPs). PBGC Rates are prescribed for use (in addition to the rare occurrence of a mass withdrawal) for withdrawal liability calculations by MEPPs that receive special financial assistance under the American Rescue Plan Act of 2021 (ARPA). In *Sofco*, the Court noted the fact that PBGC found it "reasonable to use mass withdrawal interest assumptions for purposes of calculating withdrawal liability in the context of funds covered by" ARPA does not mean that "using such assumptions is always reasonable" or overrides the unambiguous statutory mandate that the calculation must "offer the actuary's best estimate of anticipated experience under the plan" for plans not subject to ARPA.

We will continue to monitor this fascinating and hotly litigated area of the law. Qualified legal counsel should be consulted when evaluating withdrawal liability matters. If you have any questions, please contact the authors.