Legal Update Article

Impact of Critical Withdrawal Liability Interest Rate Assumption on Construction Industry Employers

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Withdrawal liability is a major concern for many employers with collectively bargained operations. While special rules applicable to the construction industry can limit the circumstances under which liability can be imposed, they do not eliminate it entirely. Recent case law on the interest rate assumption used to calculate such liability (once imposed) can dramatically affect the extent of an employer's liability.

Withdrawal liability is a statutory "exit tax" that is potentially triggered when an employer's contributions to a multiemployer pension plan (MEPP) cease in whole or in part. This form of strict liability (often substantial) can be triggered by the actions of the union or bargaining unit members. Moreover, the liability can be imposed notwithstanding an employer's compliance with all of its obligations under the relevant collective bargaining agreement.

Withdrawal liability was introduced in 1980 as part of the Multiemployer Pension Plan Amendments Act (MPPAA) and has been controversial since its enactment. There were numerous (albeit unsuccessful) constitutional challenges to MPPAA in the 1980s. Although the statute survived those challenges, the interest rate used to calculate withdrawal liability has been the subject of much litigation in the past few years. As with all withdrawal liability matters, employers must be diligent and proactive; a little foresight and planning can go a long way.

Withdrawal Liability Calculation

Withdrawal liability is triggered when an employer's collectively bargained obligation to contribute to a MEPP completely ceases *(e.g.,* when the employer completely withdraws). There is also the concept of a partial withdrawal, applicable to partial cessations of the contribution obligation. For certain construction industry employers, liability is not triggered unless the employer subsequently performs work of the type for which contributions were previously required on a noncontributory basis.

Any resulting withdrawal liability represents the withdrawn employer's allocable share of the MEPP's unfunded vested benefits (UVBs). Since UVBs represent the excess of the MEPP's cumulative obligations to make payments at some future date *(e.g.,* when a participant retires) over the value of its assets, liabilities must be discounted back to present value (using an interest rate determined by the fund actuary) to calculate withdrawal liability.

Critical Interest Rate Assumption

Although several actuarial assumptions are involved *(e.g.,* retirement rates and life expectancy), the interest rate assumption (Withdrawal Liability Interest Rate) is the "the weightiest assumption in the overall withdrawal liability calculation," according to the U.S. Court of Appeals for the District of Columbia Circuit in *United Mine Workers of America 1974*

Pension Plan v. Energy West Mining Co., 39 F.4th 730 (2022). A lower Withdrawal Liability Interest Rate generates greater withdrawal liability, which favors the MEPP and the employers not withdrawing from the plan.

Unrelated to the withdrawal liability calculation, the MEPP actuary must select an interest rate (Funding Interest Rate) for measuring compliance with statutory minimum funding requirements. A higher Funding Interest Rate makes it easier for a MEPP to satisfy these requirements. Thus, while a low Withdrawal Liability Interest Rate favors the MEPPs when calculating withdrawal liability payments, a higher Funding Interest Rate is preferable for clearing statutory minimum funding requirements.

Thirty years ago, the U.S. Supreme Court wrote, "[U]sing different assumptions [for different purposes] could very well be attacked as presumptively unreasonable." *Concrete Pipe and Products v. Construction Laborers Pension Trust Fund,* 508 U.S. 602 at 633 (1993). Several federal courts have recently addressed whether using different interest rate assumptions (for different purposes) violates the law.

Current Case Law

To date, three U.S. Courts of Appeals have held that a MEPP's use of a Withdrawal Liability Interest Rate that is lower than the Funding Interest Rate violates MPPAA.

Sixth Circuit

In *Sofco Erectors, Inc. v. Ohio Operating Engineers Pension Fund,*15 F.4th 407 (2021), the U.S. Court of Appeals Sixth Circuit held a MEPP's use of the "Segal Blend" violated ERISA.

The Segal Blend is a method that determines the Withdrawal Liability Interest Rate by blending the Funding Interest Rate with certain risk-free rates published by the Pension Benefit Guaranty Corporation (PBGC Rates).

The Sixth Circuit's analysis focused on ERISA Section 4213(a), which requires that withdrawal liability be calculated using actuarial assumptions (including the Withdrawal Liability Interest Rate) that 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."*

The Sixth Circuit interpreted the "best estimate of anticipated experience under the plan" language as referring to the "unique characteristics of the plan," such as the plan's investment asset mix and the expected rate of return on such assets. It followed, the Sixth Circuit found, that the use of PBGC Rates (a "set formula that is not tailored to the unique characteristics of the plan") to "dilute the actuary's best estimate with rates on investments that the plan is not required to and might never buy" was unlawful.

D.C. Circuit

In *United Mine Workers of America 1974 Pension Plan v. Energy West Mining Co.,*the U.S. Court of Appeals for the District of Columbia Circuit held that a MEPP's calculation of withdrawal liability using PBGC Rates as the Withdrawal Liability Interest Rate violated ERISA Section 4213(a)'s best estimate requirement. These PBGC Rates (described by the D.C. Circuit as "risk-free") are intended to approximate annuity purchase rates and must be used by MEPPs that terminate through a mass withdrawal.

Energy West aptly demonstrates the high stakes involved in the interest rate issue. At the time of withdrawal, the applicable PBGC Rate was 2.71%, and the Funding Interest Rate was 7.5%. The employer's withdrawal liability calculated using the PBGC Rates was over $115 million. By contrast, the liability calculated using the rate based on historical investment performance *(e.g.,* the Funding Interest Rate) would have been "about $40 million."

The D.C. Circuit held ERISA Section 4213(a) mandates "that the assumptions reflect the characteristics of the plan" and that "using the plan's characteristics means the actuary must estimate how much interest the plan's assets will earn based on their anticipated rate of return." It followed that the use of PBGC Rates, which bear no relationship to the plan's assets or their projected returns, violated the statute, the D.C. Circuit concluded.

Ninth Circuit

Similarly, in *GCIU-Employer Retirement Fund v. MNG Enterprises, Inc.,* 51 F. 4th 1092 (9th Cir. 2022), the U.S. Court of Appeals for the Ninth Circuit held that the calculation of withdrawal liability using PBGC Rates violated MPPAA.

Following *Sofco* and *Energy West,* the Ninth Circuit held the plain language of ERISA §4213(a) required that "the actuary's assumptions and methods reflect the plan's characteristics" and that, by using the PBGC Rates and "ignoring the expected returns of the plan's assets," the actuary "fell short of the "best estimate" standard because it was not tailored to the features of the plan." In conclusion, the Ninth Circuit issued what can be interpreted only as a blanket prohibition against the use of PBGC Rates, noting, "The discount rate assumption cannot be divorced from the plan's anticipated investment returns."

Next

We likely have not seen the last of this issue. Although the PBGC (the federal regulatory agency under ERISA) has statutory authority to promulgate regulations under ERISA Section 4213(a)(2), to date, PBGC has only proposed regulations. Further, PBGC has indicated that any final regulation would not have retroactive application. Lastly, many practitioners believe a final regulation promulgated by PBGC would remain subject to challenge under other provisions of MPPAA.

Please contact the authors if you have any questions regarding MEPPs or withdrawal liability.