

# **The Looming Multiemployer Pension Crash**

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The word ironic is misused far more often than it is used correctly. That said, perhaps no application of the word could be more appropriate than to describe how the Employee Retirement Income Security Act of 1974 (ERISA), a law designed to protect employee pensions, is now bringing about the very harm it was designed to rectify and prevent.

ERISA was enacted in response to public demands for pension reform. Americans (and thus Congress) would not tolerate a state of affairs where employees worked for decades believing that they were accruing substantial pension benefits to fund their retirement, only to find out that the promise was illusory. By regulating retirement plans, ERISA sought to ensure that promised pension benefits would be funded and available at retirement.

By failing to amend certain provisions of ERISA in response to changing U.S. economic dynamics that have significantly and adversely impacted the long-term viability of multiemployer pension plans, however, Congress has allowed these plans to become a \$165 billion-plus sinkhole beneath the U.S. economy -- one that grows deeper and wider on a daily basis. Unless Congress acts, ERISA, over the next decade, is likely to recreate, on a hundred-fold or even thousand-fold scale, the harm it was enacted to address and prevent.

## **History of ERISA**

Signed into law by President Gerald R. Ford on Labor Day in 1974, this piece of sweeping legislation was designed to address shortcomings in the previously unregulated world of employer-provided pensions. ERISA implemented a number of much-needed requirements for employers sponsoring pension plans, such as minimum funding and vesting requirements, as well as reporting, disclosure and distribution rules.

The 1963 closing of the Studebaker-Packard Corporation plant in South Bend, Ind., acted as a major catalyst for the birth of ERISA. When the plant shut down, more than 4,000 employees lost not only their jobs but also their pensions. This occurred because the law at the time permitted onerous vesting requirements; allowed employers to defer funding pension benefits so that their pension obligations remained largely unfunded; and failed to provide pensioners with direct recourse against the employer if the underfunded pension plan defaulted on its obligations. Over the following decade, and with this event as a reminder, public sentiment continued to grow in favor of pension reform. Congress responded to the clamor by enacting ERISA in 1974.

Multiemployer pension funds – sometimes referred to as Taft-Hartley funds – are a subset of ERISA-qualified pension plans and are collectively bargained pension plans that pay a defined

benefit on a periodic basis during retirement. Such funds generally cover employees in certain unionized trades and geographic regions.

Multiemployer pension funds are common in industries like construction, entertainment, transportation, shipping, automobile manufacturing, hotels and food service. Approximately 20 percent of employees participating in defined benefit plans are in multiemployer pension funds, as opposed to single employer plans. As of Sept. 30, 2010, an estimated 10.4 million Americans were participants in a multiemployer pension fund.

In many unionized industries, employees traditionally have been relatively mobile, working for different employers in the same trade in response to the employers' relative business demands. Employees have the ability to work for numerous participating employers within the same multiemployer pension fund, accruing retirement benefits under a single plan with each employer. In contrast, single employer pension plans require an employee to begin accruing pension benefits anew upon changing jobs.

There are significant differences between a single employer pension plan and a multiemployer pension plan beyond how employees accrue benefits if they change jobs. In a single employer pension plan, the employer administers and funds the pension plan, bearing the risk of loss for investments. In contrast, multiemployer pension plans are jointly administered by employer and union trustees, with the risk of loss borne collectively by the participating employers, despite the fact that such employers have little or no say with respect to day-to-day administration of the plan or the investment of its assets.

Another significant difference between single employer pension plans and a multiemployer pension plans is the manner in which they are treated by the Pension Benefit Guaranty Corporation (PBGC). The PBGC is the quasi-governmental agency created by ERISA to serve as the guarantor for insolvent pension plans. The PBGC receives no funding from general U.S. tax revenues. Instead, its operations are financed by insurance premiums from defined benefit plan sponsors; investment earnings; assets from pension plans for which it assumes responsibility; and recoveries from former plan sponsors.

For 2011, the PBGC guarantees a maximum annual pension benefit of \$54,000 per worker who retires at age 65 from a single employer plan. In contrast, the PBGC only guarantees a maximum annual pension benefit of \$12,870 per worker with 30 years of service in a multiemployer pension fund. As such, a multiemployer retiree's benefit is significantly less insured than that of a single employer retirement plan participant.

### **MPPAA's imposition of withdrawal liability**

In 1980, Congress passed the Multiemployer Pension Plan Amendments Act of 1980 (MPPAA), which amended ERISA to address certain issues specific to multiemployer pension plans. One of the most significant and controversial changes under MPPAA was the imposition of "withdrawal liability" upon any employer discontinuing its participation in a multiemployer pension plan.

Each employer contributing to a multiemployer pension fund must pay its proportionate share of the plan's underfunding at the time that it ceases participating in and contributing to the plan – this is the employer's withdrawal liability. The operative principle is that requiring each employer to pay a share of the plan's underfunding at the time of that employer's departure would reduce the burden upon those employers remaining in the plan. Withdrawal liability was designed to address the “last man standing” problem that existed under multiemployer pension plans prior to MPPAA.

Under pre-MPPAA law, if employers began to leave a multiemployer fund, there was an incentive for other employers to follow in short order to avoid being one of the final employers held responsible for funding the pension plan (often referred to as a “rush to the exit”). When employers departed a multiemployer pension plan in a rush-to-the-exit scenario, they effectively forced the plan's underfunding upon their competitors – the last man or men standing.

MPPAA enacted detailed provisions regarding how to calculate and assess withdrawal liability. Withdrawal liability generally is amortized over a 20-year period, and is imposed on affiliates and trades or businesses (whether or not incorporated) under common control with the participating employer (the employer's “controlled group”). The controlled group rules make multiemployer pension obligations and withdrawal liability a particularly serious concern in corporate transactions.

Because withdrawal liability is shared across a participating employer's controlled group, acquisitions or restructurings that include an entity with a contribution obligation to an underfunded multiemployer pension plan can inadvertently “infect” otherwise healthy companies by creating a relationship with such a fund via the controlled group rules. Additionally, the multiemployer fund can, in certain circumstances, proceed against individual shareholders to collect withdrawal liability if it is able to pierce the corporate veil.

More important, withdrawal liability can be discharged through the successful reorganization of an employer's business under Chapter 11 of the U.S. Bankruptcy Code. Where an employer uses the bankruptcy process to liquidate its business, moreover, withdrawal liability claims – usually treated as a general unsecured claim in the bankruptcy case – may be paid only pennies on the dollar. In either case, the related multiemployer plan remains underfunded – underfunding that then becomes the responsibility of the remaining employers.

### **Today's challenges**

MPPAA made numerous changes to ERISA that were acceptable for their time in the early 1980s, when unionized labor's place in the U.S. economy was stable, making it reasonable to assume that the place of a union employer that left the market would be filled by another union employer. Because their contribution bases were stable, multiemployer funds were fiscally healthy.

However, the U.S. economy has shifted fundamentally away from such unionized industries as manufacturing with the elimination of vast numbers of jobs, thanks to automation or outsourcing to foreign countries (particularly in the automotive and steel industries). According to the

Bureau of Labor Statistics of the U.S. Department of Labor (DOL), union workers made up only 12.3 percent of U.S. salary and wage workers in 2009, as compared to 21 percent in 1983. As a result, participant demographics in multiemployer pension funds have shifted. Retirees now greatly outnumber active participants in such plans. Further, as the number of unionized employers has declined, the contribution bases of most multiemployer plans have diminished significantly.

As a result of the changing place of unionized industry in the U.S. economy, withdrawal liability is no longer a vehicle for ensuring that every employer contributing to a multiemployer pension fund will pay its pension bill following its withdrawal from the fund, as contemplated under MPPAA. It has, instead, become an additional unwelcome financial hardship for remaining employers when a competitor goes bankrupt or simply closes its doors, leaving behind its “orphaned” retirees. Such employers – often themselves struggling to survive – are charged with making good on the obligations upon which their failed competitors defaulted, a consequence that was never anticipated, much less intended, by ERISA and MPPAA.

In September 2009, Moody’s Investor Services estimated that multiemployer pension funds were underfunded by a collective \$165 billion and that the 126 largest such funds (representing the “majority of assets and obligations for all multiemployer plans”) were only 56 percent funded. The remaining employers in multiemployer pension plans cannot and should not be expected to shoulder the unjust and unintended burden of funding these underfunded pension obligations.

ERISA and MPPAA were enacted to ensure the payment of promised pension benefits to retirees. However, by virtue of Congress’ ongoing failure to amend the law in response to changing economic realities, the application of ERISA and MPPAA to multiemployer pension plans has caused these plans to resemble legislatively-blessed Ponzi schemes that are unraveling because they cannot attract new investors.<sup>1</sup>

Absent legislative reform, ERISA and MPPAA surely will result in the drastic underpayment of pension benefits by multiemployer plans similar to the pensions of Studebaker employees in 1963. They will do so by strangling the remaining employers in the pension funds with dramatically increased contributions and/or withdrawal liability, thereby robbing the funds of their dwindling source of contributions and participants of their source of employment, deepening the underfunding in a vicious cycle. This paradox has been underscored only too well in recent years in the wake of the Pension Protection Act of 2006 (PPA) and the 2008 economic crisis.

### **2008-2009 – The “Perfect Storm” for Multiemployer Pension Funds**

Following some difficult investment experience in 2000-2002 and confronted with dwindling employer contribution bases, most multiemployer pension funds struggled to survive in 2007 and 2008. In a cruel twist of fate, matters were about to become far worse.

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<sup>1</sup> A Ponzi scheme is a fraudulent investment opportunity that pays purported investment profits to prior investors with funds contributed by new investors. One of the hallmarks of a Ponzi scheme is that it cannot continue to operate without a constant influx of capital from new investors (e.g., marks, rubes, suckers).

The “perfect storm” metaphor is trite, but it has particular validity with respect to the plight faced by multiemployer pension funds in 2008 and 2009. In meteorology, a perfect storm is the rare confluence of multiple weather fronts in such a manner as to generate a storm of far greater magnitude than its individual component fronts. Three superficially unrelated events occurred in late 2008 and 2009 that combined to decimate multiemployer pension funds and their participating employers.

First, PPA was enacted in August 2006, implementing enhanced funding requirements for ERISA-qualified pension plans (both single employer and multiemployer) that went into effect in 2009. PPA mandated that underfunded pension plans implement measures to bring themselves to fully-funded status over a 10-year period (subsequently pushed back to 13 years by legislation).

Second, the sub-prime mortgage crisis came to a head, resulting not only in the deepest economic downturn in the United States since the Great Depression, but also in massive losses for investors in equities (not to mention the interest rate cuts that followed). In a cruel coincidence, the effective date of PPA’s enhanced funding requirements coincided with the aftermath of the 2008 economic crisis.

Of course, as the value of plan assets was dragged down by the events of 2008, the plan’s underfunding increased dramatically. This meant that employers were forced to make increased contributions to multiemployer pension plans at a time when plan assets were very low relative to historic levels, following the losses of 2008.

The third piece of this “perfect storm” was the ongoing decline of unionized industry throughout the United States and the resulting erosion of the employer contribution bases for many multiemployer pension funds. This gradual erosion of the employer contribution bases has been exacerbated by the bankruptcy filings of other participating employers resulting from the 2008 economic downturn.

While single employer pension plans and the employers who sponsored them faced challenges under PPA’s enhanced funding requirements following the 2008 economic crisis, multiemployer pension funds and withdrawal liability have had the peculiar effect of forcing participating employers to make good on the unfunded pension obligations of those other employers in the fund who have filed for bankruptcy or simply ceased operations.

The net result of this “perfect storm” forced vulnerable multiemployer pension funds with diminishing employer bases to increase contribution levels based upon what was likely the worst funding level in the plan’s history, as required by PPA. Funding was at an all-time low because of the plummet in asset values at the end of 2008.

During 2008 and 2009, many multiemployer pension funds and participating employers were faced with the “lesser-of-two-evils” choice of either increasing employer contribution levels drastically<sup>2</sup> or undergoing a mass withdrawal. In a mass withdrawal, all or substantially all employers withdraw from the multiemployer fund and begin paying withdrawal liability. Any

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<sup>2</sup> I have personal knowledge of funds that would have had to increase contribution levels between five-fold and eight-fold in order to comply with PPA.

employers who withdrew within the preceding three years are subject to “claw-back” and the assessment of additional withdrawal liability. The pension benefits of employees are frozen and cannot increase going forward. Essentially, all current or recently-departed employers are responsible for bringing the pension plan to fully-funded status and for no additional benefit to their employees.

It should be noted that some multiemployer pension funds have employed approaches other than PPA-mandated rehabilitation plans or funding improvement plans to address their underfunding dilemmas, both before and after PPA’s effective date. Some multiemployer pension funds have decreased the rate of benefit accruals, or ceased accruals altogether, for a period of time while maintaining employer contribution levels, essentially diverting a portion or all of contributions made on behalf of current employees so as to fund the pension benefits of former employees.

### **Misalignment of incentives, risks**

While PPA’s mandate to bring pension plans to fully-funded status was painful for sponsors of single employer plans, it is difficult to escape the logic of requiring an employer to fund its pension plan for its employees and to make up for any funding shortfalls resulting from its prior investment decisions regarding plan assets. After all, during the years of strong market returns that preceded the 2008 economic downturn, an employer might have had to make little or no contribution to the plan.

Sponsors of single employer pension plans incur the risk of loss, but they also have the opportunity to benefit from asset gains during prosperous times; not so for employers participating in multiemployer pension funds. In contrast to single employer plans, employers in multiemployer pension funds have no say in the investment of plan assets. Instead, they are required by collective bargaining agreement to make regular contributions to the pension plan regardless of the plan’s funding level (employers generally are required to contribute X dollars per hour, shift or week per eligible employee). When an employer in a multiemployer pension fund files bankruptcy, its unfunded obligations ultimately are assumed by the remaining employers.

Even worse, until 2000, overfunded pension plans were not permitted to carry the surplus forward, but instead were required by law to increase pension benefits to eradicate the surplus, forcing benefit levels higher to levels that would be unsustainable in the future, particularly following the difficulties of 2008 and 2009. Rather than enjoy reduced contribution obligations or contribution holidays during strong years, employers made the same contributions as always. Participating employers in multiemployer pension funds have traditionally enjoyed little of the upside of pension plans and much of the downside. After all, in what other area of the law are businesses held responsible for the liabilities of their bankrupt competitors?

ERISA and MPPAA were never intended to cause pension plans to function in this manner. MPPAA successfully addressed the “rush to the exit” problem by instituting withdrawal liability. However, over time, the multiemployer pension funding and withdrawal liability rules have come to penalize employers who have survived challenging economic times in struggling

unionized industries by forcing them to assume the obligations of their competitors when they go out of business.

A misalignment of incentives exists not only between employers and multiemployer pension funds – it also exists between unions, present employees and retired participants in a given pension fund. That is, as discussed above, some multiemployer pension funds have reduced benefit accrual rates or temporarily discontinued accruals altogether while maintaining or even increasing employer contribution rates, essentially diverting funds intended to benefit current employees for the benefit of former employees. The interests of current employees are being subjugated to those of retirees in an effort to help the multiemployer pension plan tread water a bit longer, a clear indicator of just how poorly present law protects the interests of the employees that were the very reason for the enactment of ERISA and MPPAA.

The multiemployer pension rules put in place in 1980 worked fine while active employees in such funds outnumbered retirees, but these rules serve to destroy a plan once its demographics shift and force the active population to carry too large a burden for retired participants. The same rules that ensured accountability for pension obligations in the 1980s are strangling unionized employers three decades later.

### **The present problem**

Multiemployer pension underfunding is a \$165 billion albatross upon the U.S. economy, a massive unseen but very real liability, somewhat akin to the subprime mortgage crisis or the underfunding of Social Security. The 2009 Moody's Report reached the conclusion that "ballooning of the under[-]funded status of these funds has substantially increased the implied liability for contributing companies in the industries affected." Even worse, the Pension Benefit Guaranty Corp. (PBGC), the federal government's answer to Freddie Mac and Fannie Mae for pensions, was approximately \$23 billion underfunded as of Sept. 30, 2010. By way of comparison, the PBGC brought in \$3.1 billion in premiums for its 2010 fiscal year, meaning that it does not and will not have the means available to it to address the nearly \$200 billion in liabilities that are nearly on its doorstep (and that is without even considering the single employer pension plans for which the PBGC is responsible).

Today, most employers participating in multiemployer pension plans fall into one of three unfortunate categories. First, the largest group, are those employers forced to pay significantly increased contributions as their respective pension funds attempt to return to fully-funded status over a 13-year period in accordance with PPA mandates. In the event that an employer withdraws from the plan prior to the end of this funding improvement period, its withdrawal liability will be significantly greater than it would have been prior to PPA given that withdrawal liability formulae generally are tied to an employer's final contribution rate.

Second are those employers that had little choice but to collaborate with the union to trigger a mass withdrawal from their pension funds in order to avoid the draconian effects of PPA upon mandatory contribution levels. They have found themselves forced to begin paying withdrawal liability as of the date of the mass withdrawal.

Finally, there are the employers who have been forced to file bankruptcy as a result of the 2008 economic downturn, increased contribution requirements under PPA, withdrawal liability, or a combination thereof.

Employers who have weathered the recent economic downturn now find themselves, whether per increased contributions under PPA or per withdrawal liability following mass withdrawal, paying for the debts of their bankrupt or dissolved former competitors. Under the current and woefully inadequate legislative scheme, these employers are responsible for the orphaned retirees of a defunct competitor, retirees who likely never worked a day for them, a rather ironic reward for outlasting that competitor in the marketplace.

Saddled with these increased pension obligations, many of these employers are experiencing adverse effects upon their own fiscal well-being. This problem has been exacerbated by recent changes to financial disclosure rules by the Financial Accounting Standards Board (FASB). These changes will require companies to report multiemployer pension liabilities on their balance sheets.<sup>3</sup>

For example, a company operating in the black may, when a seven-figure withdrawal liability number hits its books, lose its line of credit due to its lender's uncertainty (even though the potential withdrawal liability is owed over a period of twenty years or more). The 2009 Moody's Report referred to this phenomenon as "a negative feedback loop: an ever-decreasing number of companies financing an ever-increasing liability." The ultimate result of this negative feedback loop will be that one employer or a few employers will remain after increased multiemployer pension contributions and/or withdrawal liability force their competitors from the marketplace – recreating the "last man standing" problem that MPPAA was designed to eliminate.

Given that current legislative provisions do not offer even the beginning of a remedy, the present predicament facing multiemployer pension funds, as well as their participants and employers, cannot and will not improve absent a legislative fix. Multiemployer pension plan underfunding will continue to claim employers, jobs, retiree pensions and plans little by little as the system continues to decay, forcing the burdens of less healthy companies onto healthy ones until their balance sheets no longer can withstand the stress.

As University of Chicago law professor Richard Epstein commented to *Institutional Investor Magazine* in May 2010, "The events of 2008 shattered the illusion of safety. You're looking at a catastrophe in 2020." The primary difference from the pension default of Studebaker in 1963 and the approaching multiemployer pension crisis is that the misery inflicted upon unsuspecting retirees by the latter will occur on a national scale to millions of Americans rather than to 4,000 residents of South Bend, Ind.

### **Now what?**

For employers that currently do not contribute to a multiemployer pension fund, there simply cannot be a sufficient justification, now or in the foreseeable future, to enter into a collective

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<sup>3</sup> FASB temporarily delayed this reporting at its May 31, 2011 meeting pending additional review and final guidance.

bargaining agreement requiring contributions to such a plan. Entering into a participating employer relationship with a multiemployer plan in the present environment potentially is tantamount to issuing a death sentence to the corporation, not to mention its affiliated trades and businesses.

Alternatives such as wage concessions, 401(k) plans or profit sharing plans can accomplish the same fundamental purpose of providing substantial retirement benefits to union employees with far greater certainty as to future liability. Also, great care must be taken in structuring corporate transactions in light of the controlled group rules so as to avoid allowing multiemployer pension liability to taint related holdings that otherwise would have no relationship with a multiemployer pension plan.

For companies that have existing relationships with multiemployer pension funds, the employer should exercise its rights to obtain certain information from the plan, which includes the right to obtain an annual estimate of its potential withdrawal liability if it were to withdraw from the fund during that year. Employers also are entitled to information regarding the plan's funding status, including actuarial information, details regarding the post-PPA measures undertaken to improve the plan's funding status, and the plan's withdrawal liability rules and procedures. Employers also should prepare themselves for the reality that FASB is going to require reporting of this information in some fashion.

For Congress, it's time to recognize the ever-worsening problem and begin the process of addressing pension reform with the enactment of an amended and restated ERISA for present times and not four decades ago. The multiemployer pension scheme constructed under ERISA and MPPAA, much like a Ponzi scheme, only works so long as new participants are being actively enrolled in order to fund the benefits of retirees and new companies sign on to take the place of departed or defunct employers. However, as discussed above, generally speaking, no company should consider undertaking such a potentially catastrophic liability (whether by signing on as a participating employer in a multiemployer pension plan or by acquiring a business that is a participating employer).

As a result of the changing role of unionized labor in the U.S. economy over the past three decades, multiemployer pension funds are beginning a process of slow implosion, much like a Ponzi scheme that can no longer attract new marks. Bernard L. Madoff Investment Securities (BLMIS) defrauded thousands of people of their retirement savings, a travesty of historic proportions, to be sure. ERISA and MPPAA, left in their present state, potentially will claim the retirement incomes of millions.

Surely, if the U.S. government had knowledge of BLMIS' activities, say, eight to 10 years earlier, Congress and governmental agencies would have acted immediately to shutter the fraudulent scheme and minimize the negative impact upon stakeholders, as well as the U.S. economy. Knowing that the multiemployer pension crash is approaching and yet failing to act is inexcusable, a direct dereliction of Congress' duties to the American people.

For a participant in a multiemployer pension fund, the proper course of action is to contact your Congressperson and tell him or her that the time to address this growing crisis is now. A retired

participant's benefit likely is woefully underfunded and insecure, while an active employee's benefit accruals likely have been reduced, discontinued or otherwise compromised while the pension fund and its participating employers focus efforts and available funds on addressing the plan's underfunding.

Legislation introduced to address the multiemployer pension crisis (such as Senator Paul Casey's "Create Jobs & Save Benefits Act of 2010" or Rep. Earl Pomeroy's and Pat Tibiri's "2009 Preserve Benefits and Jobs Act") is routinely derided by pundits as a "union bail-out" or other similar low-minded and dismissive populist drivel. This claim is particularly intellectually disingenuous when one considers that unions are not responsible for payment of a penny of the \$165 billion in multiemployer pension underfunding, but rather, that liability rests solely with the participating employers (meaning that such legislation would be more honestly labeled as a "unionized employer bail-out," a claim less sensationalistic, but which at least has the advantage of being truthful).

Given its complexity, it is not surprising that the looming multiemployer pension crash has received little coverage in the mainstream media, notwithstanding the severity of the problem. Another contributing factor, surely, is the fact that this truly is not a politically partisan issue. It's an issue of retirement income security, the primary reason for ERISA's enactment in 1974. It's about preventing a state of affairs where employees work their entire careers believing that their retirement is secure, only to find themselves elderly and impoverished because their retirement benefits were not properly funded.

Left unchanged, ERISA and MPPAA could result in the equivalent of over 2,000 Studebaker plant closings in the next decade. The fact that the use of the word ironic is appropriate in this context will be of no comfort to the millions of U.S. workers, retirees and employers whose well-being is being patently neglected, if not outright ignored, by their elected representatives.