EPSTEIN BECKER GREEN
labor and employment
ACT NOW ADVISORY

Unions Swim Against the Tide as Pension Issues Surface for Negotiations and Organizing

May 28, 2014

By Allen B. Roberts

Contributions to multiemployer defined benefit pension plans have been a mainstay, legacy feature of union negotiations in many industries. But the fabric of such staples may be tearing apart as employers contemplate the potential of escalating contributions to amortize unfunded liabilities that increase costs but may have imperceptible value for their own employees. Increasingly, employers and their employees are questioning whether the promise of retirement security can be delivered cost effectively—or at all—by defined benefit pension plans maintained under union contracts.

With private sector union membership standing at 6.7 percent nationally in 2013, major sectors of the economy and geographic areas are not affected significantly by either current unionization or successful organizing efforts. But that does not mean that all employers are untouched—or untouchable—by bargaining demands or organizing campaigns that may paint corporate retirement programs and 401(k) plans unfavorably to multiemployer plans that unions negotiate. Especially if the current National Labor Relations Board moves forward with its initiatives to abbreviate severely the length of time from notice of an election petition to the date of employee voting, unorganized employers should be armed as early as possible with reliable information about "union" defined benefit pension plans for their own decision-making and to share with employees. Similarly, employers entering a new round of collective bargaining should prepare by learning the basics of contributions relative to benefit value and business risk.

About a year ago, I wrote an item titled "Multiemployer Pension Plans—An Imperative to Define the Benefit" in Epstein Becker Green's *Take 5* newsletter, noting that "[i]t is commonplace for unions to promote the message that the multiemployer defined benefit pension plans included in the contracts that they negotiate provide comfortable retirement security—touted as 'superior' to that offered by employer or individual retirement programs—for those they represent and those they wish to organize." Current circumstances make it worthwhile to revisit this topic.

Fundamentals of Defined Benefit Pension Plans

Multiemployer defined benefit pension plans are designed to provide a defined monthly benefit at retirement based on a formula taking account of the years of employer contributions and employee service**.** Optimally for the health of defined benefit pension plans, there would be a broad base of active participants for whom regular employer contributions fund their own retirement over a working life of plan participation. Atop the broad-based pyramid would be a much smaller number of retirees and beneficiaries receiving pension benefits. Stability would come from nourishment supplied by a base of new entrants into the plan, as next generations of employees begin participation through contributions from current and newly contributing employers. But such a theoretic formula for sustainability of defined benefit pension plans has been undermined by numerous realities.

Iconic companies that once were bedrock industry participants have, in some instances, collapsed and disappeared as their fortunes reversed, or they have either relocated or outsourced previously unionized operations or lost market share (and opportunities to maintain and create jobs) to non-union domestic and offshore competitors. In growth industries that are not historically unionized, employers have designed benefits packages more appealing to employee interests, with features allowing individual elections to reflect preferences, geographic and upward mobility, and portability. For many multiemployer plans, the result has been inversion of the pyramid: fewer dollars flowing in from fewer employers and for fewer active employees, while the number of individuals having vested benefits for themselves and their spouses swells.

Of course, investment portfolio experience also is a factor in the soundness of pension funds. With a statutory mandate to diversify investment portfolios, coupled with skittishness from severe declines in 2008, many pension funds did not ride the wave of a buoyant stock market in 2013, so they showed more conservative returns that did not materially diminish a funding gap or recoup prior losses.

From time to time, Congress has stepped up with legislation like the Pension Protection Act of 2006, and more legislative “reform” is floated periodically, but at bottom, the fundamentals of multiemployer defined benefit pension plans dictate their real value to participating employees, as well as employer exposure to liability attributable to a gap between plan assets and unfunded vested benefits. By statute, annual certifications are required based on standardized funding and liquidity measures for determining the financial health of those multiemployer plans.

Due Diligence for Making Benefit Comparisons

Employers preparing for negotiations or expecting to encounter union organizing campaigns featuring comparisons of retirement benefits should take steps to conduct some due diligence concerning multiemployer defined benefit funds in the following respects:

- Benefits Relative to Dollars Contributed

Learn how dollars contributed potentially benefit employees on whose behalf the contributions are made. Defined benefit pension fund contributions typically are based on units or periods of work. To assess the value of contributions, it is important to learn how much of each dollar contributed is likely to benefit active employees whose work is the basis of the contribution. The very nature of the structure and funding of defined benefit pension plans precludes earmarking and precise tracking of contributions. However, some indicators of value are available.

- Benefit Accrual Rates

Learn about benefit accrual rates relative to dollars contributed. For legal and practical reasons, many plans suffering funding shortfalls have reduced their future benefit accrual formulas, so dollars contributed buy less credit for employee participants in the plans' current distressed times than in prior more robust or optimistic times. Historic rates of benefit accrual may have been reduced so current contributions can fund vested benefits. By way of example, if the amount of a defined benefit is a function of (1) contributions, (2) years of credited service, and (3) a benefit multiplier, then reduction of the benefit multiplier will aid in reducing unfunded vested benefits, but only by redirecting current contributions that otherwise would support a larger benefit multiplier for active employees.

- Service Credits Relative to Dollars Contributed

Learn about caps on service credit for active employees relative to the contribution obligation. Some plans require a contribution formula based on all hours worked (including overtime hours) or hours paid (including vacations, sick and personal time, holidays, and other paid time off), even though there is no additional value once a threshold is satisfied, sometimes as low as 1,000 hours and not uncommonly 1,600 hours or less. Employer contributions for hours beyond the threshold do not fund additional benefits, so employers with a workforce whose average annual hours exceed the threshold are aiding reduction of underfunding and shortfalls from other employers, but those payments may not yield value to benefit their own bargaining unit employees.

- Surcharges and Amortization Formulas for Plans in Critical Status

Learn about surcharges or amortization payments needed as part of a mandatory rehabilitation plan to fund plans in critical status. Plans considered in "critical" status because of funding and/or liquidity problems that hit certain statutory thresholds (generally, a projected funding deficiency, with consideration of whether the funding is less than 65 percent) are required to adopt a rehabilitation plan. For participants and beneficiaries having a benefit commencement date after the plan is in critical status, the rehabilitation plan may reduce or eliminate adjustable benefits, including post-retirement death benefits, 60-month payment guarantees, disability benefits (if not yet in pay status), early retirement benefits or retirement-type subsidies, benefit payment options other than a qualified joint-and survivor annuity, and benefit increases occurring in the past five years. Less severely distressed plans that are considered "endangered" (generally, assets less than 80 percent of liabilities or a projected funding deficiency within seven years) are required to adopt a funding improvement plan that may include reductions of benefits earned in future years.

If a plan is in critical status, employer contributions will be allocated either to benefits for active employees or to surcharges or amortization amounts to reduce the unfunded vested pension liabilities that have accumulated. While it fulfills statutory obligations to move a plan towards financial stability, diverting a portion of employer contributions to amortizing underfunding does not produce a tangible benefit enhancement for current employees participating in a defined benefit pension plan.

- Beneficiary Rights and Forfeitures

Learn what benefits are payable if a participating employee dies prior to the commencement of benefits or without a "surviving spouse." Many plans provide for no payment if the participating employee dies before retirement or without a beneficiary who qualifies as a surviving spouse. The effective consequence could be forfeiture of the value of anticipated benefits that were funded by long-term contributions. While extinguishing the value of a deceased participant's accrued benefits is actuarially sound, it could be disappointing to non-spouse family members or partners who survive the participant but receive none of that value.

- Withdrawal Liability

Learn about withdrawal liability that could be charged if the obligation to contribute to the multiemployer plan has ended, possibly because the employer has ended its obligation to bargain collectively with a sponsoring union or because of a permanent cessation of covered operations, as by a sale or closing of the business unit or facility that was subject to collective bargaining. Although a technical calculation subject to actuarial determination, very generally, withdrawal liability is a contributing employer's proportionate share of the plan's unfunded vested benefits. Withdrawal liability is determined by the plan's adoption of either of two allocation methods: (1) direct attribution that traces the unfunded vested benefits attributable to the employer's employees, or (2) *pro rata* that allocates liability in proportion to the employer's share of the fund's total contributions over a specified period.

Seemingly routine assumptions by fund actuaries concerning funding, investment return, or applicable mortality tables can spike withdrawal liability exposure, frequently without advance notice to affected employers or any effective opportunity to protest. Plans also have discretion to set procedures that can affect the extent and pace of exposure to withdrawal liability for newly contributing employers, so it is worthwhile learning the methods adopted for calculating withdrawal liability.

In the context of a merger or acquisition, withdrawal liability presents a potential impairment to the net worth or value of a business, whether or not the transaction actually triggers withdrawal liability payment obligations. In extreme, but not unprecedented, situations, withdrawal liability may approach or exceed the value of a business. While transactions may be structured in a way that will not trigger the seller's withdrawal liability, a purchaser willing to step into a seller's shoes and make other commitments enabling a seller to avoid a withdrawal may price its contribution commitment or a future withdrawal into the transaction cost by reducing its offer, depending upon its experience, expectations, and objectives.

- Prospect That a Healthy Plan Will Be Merged with One That Is Weaker

However sound the documented funding of a plan may be, there is the additional peril of taking on an unanticipated withdrawal liability when a relatively healthy plan is merged with one that is not as well funded. This can occur without meaningful prior notice and entirely beyond the control of a contributing employer, which may learn about it outside of customary union relations or collective bargaining only after the fact and with a ministerial notice that may not attract much attention. But the merger of a healthy fund with a currently or prospectively weaker fund, or a fund having less favorable demographics or characteristics, can severely alter financial soundness. The impact of such a merger can upset predicate expectations and projections underlying an employer's initial willingness to commence participation as a contributing employer or its analysis justifying ongoing and escalating contributions.

What Employers Should Do Now

- Don't Wait to Start Due Diligence

Employers with current contribution obligations to a multiemployer defined benefit pension plan should obtain the annual financial and actuarial reports, summary plan descriptions, and notices that the plan has filed or distributed, and they should utilize inquiries, press accounts, and fund reports to learn the plan's track record in claiming, litigating, and collecting withdrawal liability. Those without collective bargaining relationships, but whose business or industry is in the crosshairs of a particular union having an organizing agenda, should learn about the current status and trends of the multiemployer defined benefit pension plan that the union features in its collective bargaining agreements.

- Identify Value of Existing Plans

Employers not contributing to a multiemployer defined benefit pension plan should promote and modify existing benefit packages based on employee experience and satisfaction and assure that presentations for enrollment in retirement programs and reports of periodic performance are utilized to meaningfully inform and enthuse employees so that they take advantage of available benefits and appreciate their value—absolutely and relative to less rewarding and higher risk plans that could be more costly but deliver less certain value.

- Inquire About Plan Mergers

While significant advance information may not be obtained easily from union leadership or plan administrators, employers with existing union relationships and an obligation to contribute to a multiemployer defined benefit pension plan should inquire at each new round of collective bargaining whether any merger is underway or contemplated. Contributing employers then should be vigilant during the contract term for notice of a merger. As a precaution against dispersion or dilution of its future contributions or an increase in its potential withdrawal liability, the employer may propose reopening the collective bargaining agreement during the contract term to address continuing contributions if a smaller, healthier fund to which the employer contributes becomes merged into a larger fund that appears less financially sound—or if any other individual or cumulative mergers affect the soundness of the fund to which the employer contributes.

Conclusion

The disconnect between conventional wisdom and the sorry state of many underfunded pension plans is not an abstraction or academic concern; it is hitting home. Defined benefit pension plans should not be approached passively or with resignation that contributions are an inevitable fixture of collective bargaining. For unionized employers and their employees, defined benefit pension plans are much more than the "fringe" benefit that they may once have been. With proper groundwork, there is an opportunity to craft bargaining table proposals most beneficial to the current and anticipated workforce and the sustainability of business and compensation objectives. Employers targeted for organizing campaigns should become informed about costs and values associated with multiemployer plans featured in union contracts to aid their own decision-making and that of employees whose votes in a union election could be influenced by promises of retirement security—and the real-world revelations and trade-offs demonstrated through necessary due diligence applied to scrutinize those plans.

* * *

For more information about this Advisory, please contact:

Allen B. Roberts
New York
212-351-3780
aroberts@ebglaw.com

This Advisory has been provided for informational purposes only and is not intended and should not be construed to constitute legal advice.

About Epstein Becker Green
Epstein Becker & Green, P.C., founded in 1973, is a national law firm with approximately 250 lawyers practicing in 10 offices, in Baltimore, Boston, Chicago, Houston, Los Angeles, New York, Newark, San Francisco, Stamford, and Washington, D.C. The firm is uncompromising in its pursuit of legal excellence and client service in its areas of practice: Health Care and Life Sciences, Labor and Employment, Litigation, Corporate Services, and Employee Benefits. Epstein Becker Green was founded to serve the health care industry and has been at the forefront of health care legal developments since 1973. The firm is also proud to be a trusted advisor to clients in the financial services, retail, and hospitality industries, among others, representing entities from startups to Fortune 100 companies. Our commitment to these practices and industries reflects the founders' belief in focused proficiency paired with seasoned experience. For more information, visit www.ebglaw.com.

© 2014 Epstein Becker & Green, P.C. Attorney Advertising