

Multiemployer Plan Issues in the Pension Bill

August 16, 2006

On August 3, 2006, a week after approval by the House of Representatives, the United States Senate passed the Pension Protection Act of 2006 (PPA). President Bush is expected to sign the bill into law tomorrow. As noted in the LawFlash we distributed on August 7 titled "Sweeping Pension Reform Bill Passed" (http://www.morganlewis.com/pubs/EB_LF_PensionReformBill_07aug06.pdf), the new law contains significant changes relating to retirement plan funding and operations. This LawFlash is the first in a series highlighting the principal changes in the PPA.

The PPA contains significant changes for multiemployer plans, including a new system for plans facing funding difficulties, tightened withdrawal liability rules, and several new reporting and disclosure requirements. Most of these provisions take effect for plan years beginning after 2007. The PPA also will substantially increase interaction between trustees of underfunded plans and the bargaining parties.

FUNDING GENERALLY

The PPA retains the funding standard account approach under current law. However, new plan liabilities due to benefit increases and changes in actuarial assumptions will have to be amortized over 15 years instead of 30, and short-term benefits, such as "13th checks," will need to be funded by the time they are fully paid out. Plans, however, will not have to recalculate amortization schedules already in effect. In addition, the PPA raises the limit on deductions for employer contributions from 100% to 140% of current liability. It also eliminates the combined defined contribution/defined benefit plan deduction limit that currently restricts employer contributions to a defined contribution plan.

Currently, if a multiemployer plan has an accumulated funding deficiency for a year, an excise tax of five percent generally applies, increasing to 100 percent if contributions sufficient to eliminate the funding deficiency are not made within a certain period. While the current minimum funding approach will remain, there are new options to avoid funding deficiencies and to defer or avoid the excise taxes that would otherwise be imposed.

Extension of the Amortization Period

Multiemployer plans facing a funding deficiency within 10 years will be able to extend the amortization period for funding liabilities for up to five years with minimal IRS review. To qualify, a Board of Trustees (Trustees) has to adopt a program to correct the plan's funding status, certify that the

extension will resolve the funding problem, and provide notice of the extension to all affected parties. The IRS has discretion to grant an additional five-year extension, under the standards set forth in current law. These new amortization extensions will provide somewhat less funding relief than under current law, however, because the lower interest rate currently available for extensions of amortization periods is eliminated, and the regular plan funding rate will apply. The special rate currently available will still apply to extensions granted under applications that were filed before June 30, 2005.

Shortfall Funding Method

The PPA codifies use of the shortfall method to prevent funding deficiencies. Trustees may not increase benefits while the shortfall method is in use.

ADDITIONAL FUNDING RULES FOR PLANS IN ENDANGERED, SERIOUSLY ENDANGERED, OR CRITICAL STATUS

The PPA places troubled plans into three new categories—endangered status, seriously endangered status, and critical status—and imposes new funding requirements and other rules on each, including some relief from excise taxes for an accumulated funding deficiency. A plan's status is generally based on funding percentages and projected accumulated funding deficiencies. A plan is in critical status if it satisfies any one of the following four tests: (1) it is less than 65% funded, and assets plus contributions are insufficient to make benefit payments for the current year and the next six years; (2) it will experience a funding deficiency in the current year or in the next three years (four years if less than 65% funded); (3) its normal costs plus interest exceeds contributions, the present value of benefits for inactive participants exceeds the present value of benefits for active participants, and a funding deficiency is projected within five years; or (4) its assets plus five years of contributions are less than five years of benefits plus administrative expenses. A plan that is not in critical status but is less than 80% funded or has an accumulated funding deficiency in the current year or in any of the next six years is in endangered status; a plan is in seriously endangered status if it meets both of these criteria.

Actuarial Certification

Within 90 days after the start of the plan year, the plan's actuary must certify whether the plan is in endangered or critical status for the plan year. Failure of the plan's actuary to certify the status of the plan is treated as a failure to file the annual report (which means that a penalty of up to \$1,100 per day applies).

Trustees' Duties

Notify Participants, Beneficiaries, and Interested Parties

If a plan is certified to be in endangered, seriously endangered, or critical status, the Trustees must notify the plan's participants and beneficiaries, bargaining parties, the Pension Benefit Guaranty Corporation (PBGC), and the Department of Labor (DOL) within 30 days after the date of certification. The DOL is to provide a model notice.

Develop a Plan to Improve Funding Status

Trustees must adopt a Funding Improvement Plan (FIP) for plans in endangered or seriously endangered status and a Rehabilitation Plan for plans in critical status within 330 days after the start of the plan year. If the Trustees fail to adopt the applicable plan by the end of the 330th day of the plan year, a penalty of up to \$1,100 per day applies against the Trustees. Both an FIP and a Rehabilitation Plan consist of options to be proposed to the bargaining parties that are designed to bring a plan's funding up to certain benchmark levels by the end of the applicable period (Funding Improvement Period for plans in endangered or seriously endangered status, Rehabilitation Period for plans in critical status).

For plans that are in endangered status, the FIP must avoid a funding deficiency for any year during the Funding Improvement Period and reduce the percentage of underfunding by one-third by the end of the Funding Improvement Period. Plans in seriously endangered status must avoid a funding deficiency for any year during the Funding Improvement Period and reduce the percentage of underfunding by 20% over a 15-year period. A Rehabilitation Plan must be designed to have a plan emerge from critical status by the end of the Rehabilitation Period. If the Trustees determine that it is not reasonable to expect that the plan will emerge from critical status by the end of the Rehabilitation Period, the Rehabilitation Plan must include measures to emerge from critical status at a later time or to forestall possible insolvency.

The Funding Improvement Period and the Rehabilitation Period are 10-year periods that begin after the earlier of either (1) the second anniversary of the adoption of the FIP or Rehabilitation Plan or (2) the expiration of collective bargaining agreements (CBAs) that were in effect when the actuarial certification was due, and that cover at least 75% of the plan's active participants at that time. It is possible for the Funding Improvement Period or Rehabilitation Period to commence before an FIP or Rehabilitation Plan is adopted. These periods may last fewer than 10 years if plans are no longer in endangered or critical status. The Funding Improvement Period also ends if a plan's funding deteriorates from endangered status to critical status.

Reduce Adjustable Benefits

The PPA provides that, despite the anticutback rules, the Trustees may reduce "adjustable benefits" provided by plans in critical status if they deem reductions to be appropriate, subject to the outcome of bargaining over the schedules provided by the Trustees. Adjustable benefits include (1) benefits and features, including post-retirement death benefits, disability benefits not in pay status, and similar benefits; (2) any early retirement benefit or retirement-type subsidy and any benefit payment option (other than the qualified joint and survivor annuity); and (3) benefit increases adopted or effective fewer than 60 months before the plan entered critical status.

The Trustees may not reduce adjustable benefits in pay status before notifying participants, beneficiaries, employers, and unions that the plan is in critical status and that adjustable benefits may be reduced. Notice of any reduction of adjustable benefits must be provided at least 30 days before the reduction is effective. Trustees also may not reduce a participant's accrued benefit payable at normal retirement age, except for increases that had been adopted fewer than 60 months before the plan entered critical status.

Any schedule that includes a reduction in future benefit accruals must not reduce the rate of benefit accruals below (1) a monthly benefit equal to 1% of the contributions required to be made for a participant or the equivalent standard accrual rate for a participant or group of participants under the CBAs in effect as of the first day of the first year in critical status, or, if lower, (2) the accrual rate under the plan on that first day.

Adhere to FIP or Rehabilitation Plan Requirements

While the FIP or Rehabilitation Plan is being adopted, the Trustees may not accept a CBA or participation agreement that provides for (1) a reduction in the level of contributions for any participants, (2) a suspension of contributions with respect to any period of service, or (3) any new or indirect exclusion of younger or newly hired employees from plan participation. In addition, they may not adopt an amendment that increases liabilities by increasing benefits. For plans in seriously endangered status, the Trustees must take all reasonable actions during the FIP adoption period to increase the plan's funded percentage and postpone an accumulated funding deficiency for at least one year.

Once the FIP or Rehabilitation Plan is adopted, the plan may not be amended to be inconsistent with the FIP or Rehabilitation Plan, and may not be amended to increase benefits unless the actuary certifies that the increase is paid for. For plans in critical status, a plan may not be amended to increase benefits unless an actuary also certifies that the plan is still reasonably expected to emerge from critical status by the end of the Rehabilitation Period.

In addition, as soon as notice of a plan's critical status is sent, lump sum and other accelerated benefit payments may not be paid.

Consider Expedited Resolution Procedures

If the Trustees have not agreed on an FIP or Rehabilitation Plan within 60 days of the date it must be adopted, any Trustee may require that the Trustees enter an expedited dispute resolution procedure for the development and adoption of the plan.

Communicate with Bargaining Parties

Within 30 days of the adoption of an FIP or Rehabilitation Plan, the Trustees must provide schedules to the bargaining parties showing revised benefit structures, contribution structures, or both, which, if adopted, may reasonably be expected to enable the plan to meet the applicable benchmarks. For plans in endangered status, the schedules must include one proposal for reductions in the amount of future benefit accruals necessary to achieve the benchmarks, assuming no contribution increases other than those necessary after future benefit accruals have been reduced as much as possible under the law (the "default schedule"), and one proposal for increases in contributions necessary to achieve the benchmarks assuming no reductions in future benefit accruals. Trustees of plans in critical status must include the default schedule.

If the bargaining parties fail to agree on changes to contribution and/or benefit schedules necessary to meet the applicable benchmarks, the Trustees must implement the default schedule upon the earlier of (1) the date on which the DOL certifies that the parties are at an impasse, or (2) the date that is 180 days

after expiration of the last CBA that was active when the plan's status was certified.

Penalties and Surcharges

Excise Tax on Employers Failing to Meet Required Contributions

If an FIP or Rehabilitation Plan requires an employer to make contributions to the plan, an excise tax applies upon the failure of the employer to make the required contributions within the time required under the plan. The amount of the tax is equal to the amount of the required contribution the employer fails to make.

Additional Contributions (Surcharge) in Critical Status

Under the new system, the excise tax that currently applies to plans with accumulated funding deficiencies is suspended for plans in critical status. Employers can escape the excise tax while a plan is in critical status as long as they are implementing a program to improve the plan's funding status.

However, once employers are notified that a plan is in critical status, an additional required contribution (surcharge) is imposed. In the first plan year of critical status, the surcharge equals 5% of the contributions an employer is required to make. The surcharge increases to 10% of required contributions in succeeding plan years if the plan remains in critical status. Failure to make the surcharge payment is treated as a delinquent contribution. The surcharge is no longer required when a collective bargaining agreement (CBA) includes terms consistent with a schedule under a Rehabilitation Plan that the Trustees are required to adopt. Contributions attributable to the surcharge may not be the basis for any benefit accrual.

Nonbargained Participants

For any employer that contributes to an endangered or critical plan for both bargaining unit and nonbargained employees, benefits and contributions for the nonbargained employees, including surcharges, must be determined as if the nonbargained employees were covered under the first to expire of the employer's CBAs in effect when the plan entered endangered or critical status. Employers that contribute to multiemployer plans only with respect to nonbargained employees are treated as the bargaining party and the participation agreement is treated as a CBA.

ADDITIONAL PROVISIONS CONCERNING MULTIEMPLOYER PLANS

Measures to Forestall Insolvency

Unless the Trustees determine that the value of plan assets exceeds three times the total amount of benefit payments, the Trustees must determine whether the plan will be insolvent for any of the next five years, an increase from three years under current law.

Withdrawal Liability Changes

Updated Insolvency Table

For asset sales occurring on or after January 1, 2007, the PPA reduces the portion of a plan's unfunded vested benefits that may be attributed to an employer selling all or substantially all of its assets to an unrelated party in an arm's length transaction.

Partial Withdrawal Liability

Under current law, a partial withdrawal occurs if an employer permanently ceases to have an obligation to contribute under one or more, but fewer than all, of its CBAs requiring contributions, if it continues to perform the work without making contributions, or if it transfers the work to another location. In addition to that rule, the PPA imposes liability if the employer transfers the work to an entity or entities owned or controlled by the employer. This provision is effective for work transferred on or after the date of enactment.

Eased Rule for Withdrawal Liability for Small Employers

Under the bill, the employer will not have to make liability installment payments while challenging the plan's assessment if (1) Trustees determine that a complete or partial withdrawal of an employer has occurred or an employer is liable for withdrawal liability payments and (2) the determination is based on a finding that a principal purpose of a prewithdrawal transaction was to evade or avoid withdrawal liability. The transaction must have taken place after December 31, 1998 and at least five years before the date of the withdrawal. For small employers, the transaction must have occurred at least two years before the withdrawal. If the dispute is not resolved within 12 months, the employer will have to post a bond or provide an escrow account covering the interim liability payments that would otherwise have been required.

Other Withdrawal Liability Changes

For the first time, construction industry plans will be able to adopt the "free look" rule. This rule allows a new contributing employer to avoid withdrawal liability if its contribution obligation lasts no longer than the number of years required for vesting under the plan and the employer meets other conditions.

In addition, the PPA permits plans primarily covering employees in the building and construction industries to modify the presumptive method for calculating withdrawal liability. This method divides a plan's unfunded vested benefits into 20 separate pools of liability. When withdrawal liability was originally included in ERISA, the first pool consisted of the total unamortized amount of unfunded vested benefits at the end of the plan year ending before September 26, 1980. The new law permits a plan to substitute a different date for September 26, 1980, as long as the new plan year for measuring the first pool of liability has no unfunded vested benefits.

New Notice Requirement

For plan years beginning after 2007, the Trustees must give participants, beneficiaries, bargaining parties, and the PBGC a new annual notice within 120 days of the beginning of the plan year. The bill directs the DOL to publish a model notice.

Sunset in 2014

The PPA directs the DOL, the IRS, and the PBGC to conduct a study of the effect of the changes made by the bill on multiemployer plan operations and funding by December 31, 2011. The bill further provides that the rules relating to the automatic amortization extension, the shortfall funding method, and plans in endangered and critical status, will not apply to plan years beginning after December 31, 2014. The current rules (those in effect prior to the enactment of the PPA) are reinstated for plan years beginning after 2014, except that amortization schedules, FIPs, and Rehabilitation Plans in effect on December 31, 2014 will continue.

If you have any questions regarding how the PPA will affect your multiemployer plan, please feel free to contact your Morgan Lewis attorney or any of the following individuals:

Dallas

Riva T. Johnson 214.466.4107 rjohnson@morganlewis.com

New York

Craig A. Bitman 212.309.7190 cbitman@morganlewis.com

Philadelphia

Brian J. Dougherty 215.963.4833 bdougherty@morganlewis.com
Steven D. Spencer 215.963.5714 sspencer@morganlewis.com

Pittsburgh

John G. Ferreira 412.560.3350 jferreira@morganlewis.com

San Francisco

Mark H. Boxer 415.442.1695 mboxer@morganlewis.com

Washington, D.C.

Harry W. Burton 202.739.5105 hburton@morganlewis.com
David P. Cohn 202.739.5586 dcohn@morganlewis.com
Margery Sinder Friedman 202.739.5120 mfriedman@morganlewis.com
Donald L. Havermann 202.739.5072 dhavermann@morganlewis.com
John F. Ring 202.739.5096 jring@morganlewis.com

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