Multiemployer Pension Plan

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If you talk with anyone in private equity, they will typically tell you they are looking for companies with high barriers to entry, EBITA margins above 10%, recurring revenue, and finally, no unions. Although companies with collective-bargaining agreements with unions can present challenges, they can also be good investments. Typically, collective-bargaining agreements between a company and a union require the company to make retirement contributions for the covered employees to a multi-employer pension plan (MEPP). A MEPP is a defined benefit pension plan jointly administered by the union and representatives of some of the employers that have entered into agreements with the union. Most private equity funds are familiar with the difficulties and risks of defined benefit pension plans. However, there are attributes of MEPPs that represent additional risks and need to be taken into consideration before making an acquisition.

Multiemployer Pension Liabilities

The contribution obligation in a collective-bargaining agreement for a Company participating in a MEPP is typically phrased as a set hourly, weekly, or monthly contribution per covered employee. While this can be expensive and subject to increase each time an agreement is renegotiated, the cost is predictable and can be factored into your projections. Since the 1970 the number of active workers participating in a MEPP has remained basically flat. However, the increased number of retired and terminated-vested workers, improved life expectancy, significantly low interest rates, and subpar returns on investments have caused many of these plans to be underfunded; and in many cases, significantly underfunded.

In 2006, Congress passed the Pension Protection Act to address the underfunding of pension funds across the country. The Act created funding categories called "Zones." "Green" is considered healthy and means the fund is 80% funded or higher. "Yellow" is labeled as endangered with the fund being under funded by 65% to 79%. "Red" means the fund is considered critical and the fund is less than 65% funded. These pension liabilities do not show up on the company's financials, but rather as a footnote.

Employers are provided a written report yearly listing the status of the pension fund and the employers portion of the unfunded liability. When plans reach the "Red" status, they will move into a rehabilitation phase which may require employers to pay a surcharge on their contributions to the MEPP. These unanticipated additional contributions can be detrimental to a cost structure mapped out prior to the acquisition. During due diligence, buyers should be sure to ask about the status of the MEPP and request the report listing the unfunded pension liability.

Withdrawal Liability

The potential assessment of withdrawal liability is even more of a concern than the surcharges and increased contributions. The assessment of withdrawal liability arises when a company incurs a partial or complete withdrawal from the MEPP or when the MEPP shuts down (becomes insolvent or incurs a mass withdrawal of all the participating employers). In such event, the participating company is assessed its pro-rata portion of the plan's underfunding. The rules are complicated and are beyond the scope of this article. However, the poor financial shape of many of the MEPPs has resulted in very large assessments of withdrawal liability. In addition, as companies participating in MEPPs go bankrupt or out of business, the remaining participating companies have to affectively pick up the slack. Thus, their pro-rata portion of the underfunding, their potential withdrawal liability, increases.

In 1974, Congress passed the Employee Retirement Income Security Act, more commonly known as ERISA. The legislation, along with the Multiemployer Pension Plan Amendments Act of 1980 which made major changes to the rules for MEPPs, were intended to create minimum standards to protect employees of private sector employers who have retirement and welfare benefit plans. ERISA makes all "trades or businesses" in a "controlled group of corporations" jointly and severally liable for each other's pension obligations. This includes withdrawal and/or plan termination labilities. Thus, if a company that participates in a MEPP incurs withdrawal liability, the MEPP (or the Pension Benefit Guaranty Corporation (the PBGC), the quasi-governmental company that insures private pension plans and MEPPS), can go after any member of the company's controlled group for the withdrawal liability. The two acts also provide a substantial amount of discretion and authority for the administrators of MEPPs to determine when a partial or complete withdrawal has occurred and the amount of withdrawal liability that is due.

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Sun Capital v New England Teamsters & Truckers Industry Pension Fund

Private equity-held companies are typically structured to avoid these ERISA controlled group risks. Thus, if a private equity owned entity withdrew from a MEPP, the MEPP traditionally could only go after the participating company. This changed in the First Circuit court case Sun Capital III, LP v. New England Teamsters in 2013. In this case, Sun Capital Advisors, Inc. is a private equity firm specializing in leveraged buyouts. In 2006, Sun Capital pulled money from two of its funds (Sun Capital Partners III, LP and Sun Capital Partners III QP, LP) to acquire Scott Brass, Inc, a metals producer. In an effort to turn the company around, Sun Capital's co-CEOs, Marc Leder and Rodger Krouse, "exerted substantial operation and managerial control." Despite Sun Capital's best efforts, declining copper prices forced Scott Brass to file for bankruptcy in 2008. After bankruptcy, Scott Brass stopped making payments to the New England Teamsters Pension Fund, this triggered a complete withdrawal from the fund and an assessment of withdrawal liability of $4.5 million in "unfunded vested benefits." The Teamsters filed suit alleging Sun Capital's relationship with Scott Brass made Sun Capital jointly and severally liable for the withdraw liability.

The First Circuit concluded that in certain circumstances, a private equity fund was more than simply an investor (applying what was referred to as an "investment plus" test) and could be regarded as a "trade or business" for the purposes of ERISA's controlled group rules. The First Circuit also concluded that two of the funds (Sun Capital Partners III, LP and Sun Capital Partners III QP, LP) were effectively a "partnership-in-fact" (they routinely invested together in multiple investments) and, thus, should be treated as a single entity because they were parallel funds, shared a single general partner, and had routinely coordinated their investments.

In 2019, after a lengthy legal battle and the case being heard before several courts, the First Circuit reviewed the case on remand and considered established federal tax law principles to determine if Fund III and Fund IV formed a partnership. The First Circuit concluded the district court had incorrectly applied the "Luna factors" and a partnership in fact was not formed because the Funds together did not own 80% of Scott Brass and thus were not liable for the withdrawal liabilities.

Conclusion

The Court of Appeals for the First Circuit's 2019 decision upheld important parts of its 2013 decision, chiefly upholding the "investment plus" test and finding that a private equity fund could be considered a "trade or business" for the purposes of the controlled group rules and pension liabilities, and funds that are co-investing and controlled by the same individuals could be deemed a "partnership in fact" and, thus, treated as a single entity. Private Equity will need to be mindful of this ruling when making investments in companies with significant exposure to underfunded pensions. Any single fund or closely related funds should avoid acquiring 80% or more of the targeted company to reduce the impact of the ERISA controlled group rules. Having unrelated co-investors who takes a 21% or more interest in the target could help address this risk.

Nonetheless, if you presently have a company that participates in a MEPP, you should examine your exposure and take actions that will help to reduce or eliminate it. Furthermore, before acquiring a company that participates in or has exposure to a MEPP, consulting with experienced legal counsel will be critical when making these kinds of investments.

If you have additional questions regarding multi-employer pension plans and how they impact M&A, please contact Chuck Fenske (cfenske@peasecapital.com) and John Wirtshafter (jwirtshafter@mcdonaldhopkins.com).