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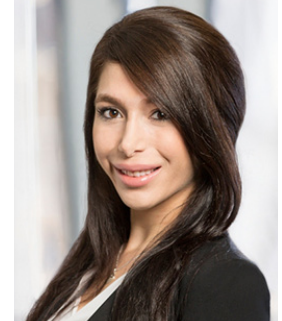
Buyers Beware! Ninth Circuit Holds that a Company May Be Subject to Withdrawal Liability as a Successor Employer under the "Successorship Doctrine"



ANGEL L. GARRETT
AND ALYSSA OHANIAN

On September 11, 2015, the Ninth Circuit, in *Resilient Floor Covering Pension Trust Fund Board of Trustees v. Michael's Floor Covering, Inc.*, Case No. 12-17675, 2015 WL 5295091, joined the Seventh Circuit in holding that an employer may be subject to withdrawal liability as a successor under the Multiemployer Pension Plan Amendments Act ("MPPAA"), amendments to the Employee Retirement Income Security Act of 1974 ("ERISA"). In light of this ruling, asset purchasers should be careful of any future acquisitions because they may be responsible for the seller's withdrawal liability under the "successorship doctrine," a common law doctrine that provides an exception to the general rule that a purchaser of assets does not acquire a seller's liabilities.

Background

The predecessor employer, Studer's Floor Covering, Inc. ("Studer's"), was in the construction industry, selling and installing floor products to commercial and residential customers. At the end of 2009, the president and chairman of Studer's, Scott Studer, told his sales staff that Studer's would close at the end of the year. Michael Haasl, a salesman at Studer's for over 19 years, informed Studer that he planned to bid for projects for his new flooring sales and installation company, Michael's Floor Covering, LLC ("Michael's").

The day after Studer's closed, January 1, 2010, Haasl opened Michael's in the same location as Studer's. He purchased signs for Michael's that were very

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similar to those of Studer's and took over Studer's business telephone numbers. Michael's also hired five former Studer's employees and purchased approximately 30% of Studer's' tools, equipment, and inventory at a publicly advertised liquidation sale. However, Studer's did not provide or sell Michael's its customers' information. Instead, Michael's developed its business through the business relationships Haasl established during his time as a Studer's salesman.

Prior to its dissolution, Studer's was a party to a collective bargaining agreement ("CBA") with the Linoleum, Carpet and Soft Tile Applicators Local Union No. 1236. Pursuant to this CBA, Studer's made regular pension contributions to the Resilient Floor Covering Pension Trust Fund ("the Fund"). The Fund is a multiemployer defined benefit pension plan subject to the MPPAA, which provides that an employer withdrawing from a multiemployer pension plan is liable to the plan for withdrawal liability. However, there is an exception to this general rule for construction companies that close and do not resume operations within the jurisdiction of the CBA for at least five years. When Studer's ceased operations in 2009, it stopped making contributions to the Fund. Because Michael's was not a party to the CBA, it did not make any contributions to the Fund.

District Court's Decision

The Fund and its Board of Trustees brought a lawsuit in the Northern District of California against Michael's claiming that it was a successor to Studer's and, therefore, responsible for Studer's withdrawal liability in the amount of $2,291,014 or, in the alternative, unpaid contributions. The district court disagreed. In reaching its decision, the district court looked to the common law successorship doctrine and applied the multi-factor successorship test set forth in *NLRB v. Jeffries Lithograph Co.* ("*Jeffries*"), 752 F.2d 459 (9th Cir. 1985). According to *Jeffries*, a court must consider the following factors in determining successorship: whether there is continuity in the workforce, whether the same jobs exist under the same working conditions, whether the same supervisors were employed, whether the same service is offered, whether there was a substantial continuity of the business, and whether the same machinery, equipment, and methods of production are used. Despite the fact that Michael's used the same plant as Studer's and that many of Studer's customers became Michael's customers, the district court concluded that Michael's was not "essentially the same as Studer's" because other factors weighed against successorship (*e.g.*, there was no continuity of the workforce because Michael's did not employ a substantial portion of Studer's employees) or were neutral (*e.g.*, whether the same machinery, equipment, and methods of production are used, and whether the same service is offered).

Ninth Circuit's Decision

On appeal, the Ninth Circuit reversed the district court's decision. It held that a successor employer could be subject to MPPAA withdrawal liability, so long as the successor took over the business with notice of the liability. The Ninth Circuit also held that the most important factor in determining if an employer is a successor for purposes of withdrawal liability is whether there is substantial continuity in the business operations between the predecessor and successor companies.

The Ninth Circuit stated that although it had not previously determined whether an employer could be subject to MPPAA withdrawal liability under the successorship doctrine, it has applied this doctrine in cases involving delinquent ERISA contributions. The court explained that it had imposed liability for the seller's delinquent ERISA contributions on the purchaser because "[a]bsent the imposition of successor liability, present and future employer participants in the union pension plan will bear the burden of [the predecessor's] failure to pay its share," which would threaten the health of the plan while the purchaser reaps a windfall. *Resilient Floor Covering Pension Trust Fund Bd. of Trustees*, 2015 WL 5295091 at *10. The court reasoned that this rationale applies with equal, if not greater, force in the withdrawal liability context. One of ERISA's purposes is "to ensure that employees and their beneficiaries [a]re not . . . deprived of anticipated retirement benefits by the termination of pension plans before sufficient funds have been accumulated in the plans." *Id.* The MPPAA carries out this purpose by assessing proportional liability on the withdrawing employer. The court explained that while a plan's funding remains relatively

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constant when a contributing construction employer stops doing business at the time it withdraws from a plan, the same cannot be said for a non-union employer that continues doing the same work. This non-union employer obtains the benefit of doing the work of the previous unionized employer but does not contribute to the plan. Therefore, imposing successor liability on an employer that continues the business of its predecessor is necessary to protect the "viability of pension funds in the face of a shrinking contribution base." *Id.* at *11.

In reversing the district court's decision, the Ninth Circuit disagreed with the district court's holding that "continuity of workforce" was the most important factor in determining whether an employer was a successor responsible for the predecessor's withdrawal liability. Instead, the Ninth Circuit held that the most important factor is whether there is "substantial continuity in the business operations between the predecessor and the successor, as determined in large part by whether the new employer has taken over the economically critical bulk of the prior employer's customer base." *Id.* at *1. The Ninth Circuit noted that certain other factors, such as whether "the new employer uses the same plant" and whether "the same product is manufactured or the same service is offered," may also be relevant in determining whether the successor has actively and successfully captured the predecessor's market share. *Id.* at *13. Ultimately, the more the successor models itself after the predecessor — such as Michael's taking over Studer's location and phone numbers and making signs that looked almost identical to Studer's (both spelled out the company's name in the same size and color font on a white background) — the more likely a court will find that the successor effectively captured the predecessor's market share.

The Ninth Circuit explained that although the composition of the workforce is important in successorship cases involving the duty to bargain under the National Labor Relations Act ("NLRA"), that factor is not of special relevance when considering MPPAA withdrawal liability. In the NLRA context, a change in ownership is unlikely to change the employees' attitude towards union representation and, therefore, it is fair to require the successor employer to bargain with the incumbent union if it hires a majority of the predecessor's employees. The purpose of the MPPAA is to protect a plan's funding, which is based on the amount of work available in a certain area. Therefore, the focus for determining if an employer is a successor liable for the predecessor's withdrawal liability is whether this new employer has captured the predecessor's market share. Accordingly, the Ninth Circuit reversed the district court's decision and remanded the case back to the district court for further consideration on the successorship question.

Key Takeaways

The Ninth Circuit's decision has important implications for entities or individuals interested in purchasing assets from another company. Potential purchasers of assets should keep in mind that the successorship doctrine may be used to impose withdrawal liability that could be extremely costly for their new business. As seen in this case, Michael's may eventually be liable for over $2 million in withdrawal liability. Purchasers should carefully examine the target company's potential withdrawal liability, especially if they are purchasing parts of a liquidated business or in other circumstances in which there is a high likelihood that they will be acquiring the predecessor's customer base. If potential withdrawal liability exists, the employer should consider structuring the transactions to account for this liability — for instance, through indemnification or adjustment of the purchase price, or through ERISA's special provision exempting certain asset sales from withdrawal liability. Ultimately, purchasers should carefully examine the target company's liabilities and understand potential pension obligations before entering into a purchase and sale agreement.

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The DOL Clarifies Its Safe Harbor Guidance for Selecting Annuity Providers and Contracts for Defined Contribution Plans

NICHOLAS J. WHITE

In 2008, the Department of Labor (DOL) issued a safe-harbor regulation for plan investment fiduciaries regarding a prudent process for selecting and monitoring annuity providers and contracts for defined contribution plans (the "Safe Harbor Rule"). In Field Assistance Bulletin (FAB) 2015-2 (the "FAB"), issued this past summer, the DOL provides guidance that clarifies the Safe Harbor Rule, in response to what the DOL says is a "recurring comment" from plan fiduciaries that the Safe Harbor Rule remains unclear as to the scope of their obligations with respect to selecting annuities.

In particular, the DOL says questions continue to be raised about how to reconcile the "time of selection" standard in the Safe Harbor Rule — "which embodies the general principle that the prudence of a fiduciary decision is evaluated under ERISA based on the information available at the time the decision was made" — with the fundamental fiduciary obligations to continue to monitor and review fiduciary decisions. The DOL also expresses concern that "confusion or lack of clarity regarding the nature and scope of fiduciary responsibilities to act prudently in making, monitoring and reviewing annuity selections under a defined contribution plan could lead plan sponsors or their advisors in some instances to overestimate or otherwise misunderstand the duration or extent of those fiduciary responsibilities." And, these problems could amount to disincentives to offering plan participants annuities as a lifetime distribution option. To address these concerns, the FAB focuses on the issue of how to apply the "time of selection" standard of the Safe Harbor Rule.

Somewhat unfortunately, the FAB does not address the extent to which, if at all, the Safe Harbor Rule applies to the selection of insurance companies and products providing for guaranteed payments *other* than an immediate annuity or a qualifying longevity annuity contract (a "QLAC") option. However, the DOL does note in the FAB that "The Department is considering guidance on fiduciary selection and monitoring of annuity providers and contracts that are offered as investment options under defined contribution plans as part of its project on the Department's regulatory agenda to evaluate possible amendments to the Safe Harbor Rule." Until such guidance is provided, plan investment fiduciaries will have to rely on the general fiduciary standards described below, including the Safe Harbor Rule.

General Fiduciary Standards

ERISA imposes high standards upon fiduciaries responsible for managing the operations of retirement plans. Section 404(a) of ERISA sets forth the key fiduciary duties of: (i) absolute loyalty to the plan participants and their beneficiaries (*e.g.*, the requirement to act solely in their best interests); (ii) the exclusive purpose requirement (*e.g.*, to duty provide benefits at a reasonable cost); and (iii) the prudent person rule (*e.g.*, the requirement to act with the care, skill, prudence and diligence of what amounts to an expert). ERISA does not specifically explain how fiduciaries must fulfill these duties; however, the DOL explains the relevant standards through advisory opinions, regulations and other guidance.

Specifically, in describing a prudent selection process for an annuity provider, the DOL explained what is required of a fiduciary by stating in Interpretive Bulletin 95-1(c) as follows:

> "In addition, the fiduciary obligation of prudence... requires, at a minimum, that plan fiduciaries conduct an objective, thorough and analytical search for the purpose of identifying and selecting providers from which to purchase annuities."

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Clearly, this guidance requires fiduciaries to be diligent in gathering relevant data and analyzing it thoroughly and objectively for the purpose of making informed decisions that are in the best interest of the plan, its participants and beneficiaries.

Furthermore, under ERISA plan fiduciaries have an ongoing duty to prudently monitor and evaluate service providers, investments and other plan activities. That is, fiduciaries must review their decisions periodically to ensure that they continue to be prudent in light of the current circumstances of the plan. And this duty to monitor must be carried out using the same prudent process required with respect to the initial fiduciary decision. (*See* DOL Interpretive Bulletin 96-1(e).)

Specific Fiduciary Standards and DOL Safe Harbor Guidance for Selecting Annuities and Annuity Providers for a Defined Contribution Plan

The determination of which annuities and providers to offer retirement plan participants is a fiduciary decision, as it is an exercise of discretion regarding management and control of a plan and its assets, as described in ERISA §3(21). And, as is the case with any investments offered to plan participants, the fiduciaries responsible for administering the plan must engage in a prudent decision-making process regarding the selection and retention of those annuities. That is, the process must be carried out in accordance with the ERISA standards of (i) the "duty of loyalty"; (ii) the "exclusive purpose requirement" and (iii) the "prudent person rule." Furthermore, the fiduciary must make certain the process by which it makes the relevant selections is free from self-dealing and conflicts of interest, and it should include consideration of multiple annuity providers; that is, it should be a truly independent and informed decision. (*See* ERISA §404(a)(1)(B), DOL Reg. §2550.404a-1, the preamble to DOL Reg. §2550.404c-5(b)(1) and the Safe Harbor Rule, discussed below.) Then, after the selections have been made, the fiduciaries have a duty to periodically re-evaluate (monitor) these decisions to make sure they continue to be appropriate for the plan, its participants and their beneficiaries.

With respect to the selection of an annuity provider for a defined contribution plan, the DOL provides guidance in Reg. §2550.404a-4. This regulation does not establish the exclusive means by which a plan fiduciary satisfies its responsibilities with respect to the selection of an annuity contract and/or provider, but it does serve as important guidance, and particularly so because it contains the Safe Harbor Rule in subparagraph (b) thereof.

The Safe Harbor Rule describes actions that defined contribution plan fiduciaries can take to satisfy their ERISA fiduciary responsibilities in selecting annuities and their providers. According to the DOL, the Safe Harbor requirements are satisfied if the plan's fiduciary:

- engages in an objective, thorough and analytical search for the purpose of identifying and selecting providers from which to purchase annuities. This process must avoid self-dealing, conflicts of interest or other improper influence and should, to the extent possible, involve consideration of competing annuity providers;
- appropriately considers information sufficient to assess the ability of the annuity provider to make all future payments under the annuity contract;
- appropriately considers the cost (including fees and commissions) of the annuity contract in relation to the benefits and administrative services to be provided under such contract;
- appropriately concludes that, ***at the time of the selection***, the annuity provider is financially able to make all future payments under the annuity contract and the cost of the annuity contract is reasonable in relation to the benefits and services to be provided under the contract; and
- if necessary, consults with an appropriate expert or experts for purposes of compliance with these provisions.

For purposes of the forgoing requirements, the DOL explains that "the time of selection" means:

- the time that the annuity provider and contract are selected for distribution of benefits to a specific participant or beneficiary; or

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- the time that the annuity provider is selected to provide annuities as a distribution option for participants or beneficiaries to choose at future dates.

Consistent with the duty to monitor, the Safe Harbor Rule provides that when an annuity provider is selected to offer annuities that participants may later choose as a distribution option, the fiduciary must periodically review the continuing appropriateness of the conclusion that the annuity provider is financially able to make all future payments under the annuity contract, as well as the reasonableness of the cost of the contract in relation to the benefits and services to be provided. ***The fiduciary is not, however, required to review the appropriateness of its conclusions with respect to an annuity contract purchased for any specific participant or beneficiary***, as is made clear in paragraph (c)(2) of the Safe Harbor Rule.

The FAB cites authority from a number of court cases in explaining that fiduciary prudence is to be "evaluated with respect to the information available at the time the decision is made — and not based on facts that come to light only with the benefit of hindsight." Furthermore, to clarify the timeline for a fiduciary's ongoing duty to monitor annuity products, the DOL states in the FAB that the "fiduciary's selection and monitoring of an annuity provider is judged based on the information available at the time of the selection, and at each periodic review, and not in light of subsequent events."

With respect to the periodic review requirement of the Safe Harbor Rule, the FAB states in relevant part as follows:

> The periodic review requirement . . . does not mean that a fiduciary must review the prudence of retaining an annuity provider each time a participant or beneficiary elects an annuity from the provider as a distribution option. The frequency of periodic reviews to comply with the Safe Harbor Rule depends on the facts and circumstances. For example, if a "red flag" about the provider or contract comes to the fiduciary's attention between reviews (e.g., a major insurance rating service downgrades the financial health rating of the provider or several annuitants submit complaints about a pattern of untimely payments under the contract), the fiduciary would need to examine the information to determine whether an immediate review is necessary, or, depending on the facts and circumstances, the fiduciary may need to conduct an immediate review.

By way of an example regarding the purchase of an immediate annuity, the DOL confirms that once an annuity contract is actually selected for a particular participant or beneficiary, future changes in the qualifications (suitability) of the annuity provider are not applicable to the determination of whether the fiduciary acted prudently in selecting the provider, because that issue is to be assessed as of the date the annuity was purchased, and not thereafter. That is, there is no fiduciary duty to review the appropriateness of any annuity that has already been purchased. In a second example, regarding the purchase of a deferred annuity (a QLAC), the DOL confirms that the duty to monitor an annuity provider ends when the plan stops offering annuities from that provider, and not when all the annuities from that provider have been paid out. Thus, the FAB clarifies any confusion that may have led some to erroneously conclude that the duty to monitor extends beyond the time when purchases from an annuity provider cease.

Final Comments

As with any investment or product offered to plan participants, fiduciaries must be careful to engage in a prudent, thoughtful process of gathering relevant information, assessing that information and making informed, well-reasoned decisions both about whether to offer annuities and, if so, which providers and products best fit the particular needs of the plan participants.

The applicable standards require the fiduciaries to engage "in an objective, thorough and analytical search in identifying and selecting providers" (DOL Reg.§ 2550.404a-4(b)(1)). And, even if the Safe Harbor Rule is not used, plan investment fiduciaries should, at a minimum, undertake a process to gather information regarding competing providers. This information will provide the fiduciaries with a reasonable starting point to assess what the DOL indicates they have an absolute duty to assess — that is, costs, product features, the financial stability of the annuity provider, and administrative capabilities of competing providers.

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The fiduciaries must then determine ***at the time they are making the decision*** regarding annuities and annuity provider, and with the advice of experts to the extent necessary (*see* DOL Reg. §2550.404a-4(b)(5)), that the information they have gathered and analyzed reasonably supports a determination that the annuity product is suitable for the plan and the provider is financially able to make future payments under the contract, and that the cost of the contract is reasonable in view of the benefits and services to be provided (*see* DOL Reg. § 2550.404a-4(b),(2) and (4)). Thereafter, the fiduciaries must continue to periodically assess the appropriateness of the annuity and the annuity provider as facts and circumstances change (DOL Reg. § 2550.404a-4(c)).

Finally, as a matter of best practices, both the initial and ongoing evaluative processes should be captured in writing with sufficient detail to substantiate compliance with the ERISA's high fiduciary standards.

Pension Plan Limitations and Other Applicable Limitations for 2016

SHANNON OLIVER
AND KEVIN E. NOLT

The Internal Revenue Service (the "IRS") has announced the annual cost-of-living adjustments applicable to dollar limitations for retirement plans and other items for Tax Year 2016. The retirement plan limitations generally are unchanged in 2016 because in most cases the slight increase in the cost-of-living index did not meet the statutory thresholds that trigger rate adjustments. The following is a list of the key dollar limitations which have not changed. Additional information on the 2016 limitations can be found in IRS Notice 2015-75.

- The annual compensation limit remains unchanged at $265,000 (Code sections 401(a)(17), 404(l),408(k)(3)(C), and 408(k)(6)(D)(ii)).
- The limitation on the annual benefit under a defined benefit plan remains unchanged at $210,000 (Code section 415(b)(1)(A)).
- The compensation amounts used in defining "control employee" for fringe benefit valuation for Board or shareholder-appointed, confirmed, or elected officers of the employer remains unchanged at $105,000. The compensation amount used for all other employees of the employer remains unchanged at $215,000 (Reg. sections 1.61–21(f)(5)(i) and 1.61–21(f)(5)(iii)).
- The limitation for defined contribution plans remains unchanged at $53,000 (Code section 415(c)(1)(A)).
- The maximum amount of elective deferrals that may be made to 401(k) plans, 403(b) plans, simplified employee pensions ("SEPs"), and 457(b) plans remains unchanged at $18,000 (Code sections 402(g)(1) and 457(e)(15)).

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- The maximum amount of catch-up contributions that individuals aged 50 or over may make to 401(k) plans, 403(b) plans, SEPs, and governmental 457(b) plans remains unchanged at $6,000 (Code section 414(v)(2)(B)(i)).
- The maximum amount of catch-up contributions that individuals aged 50 or over may make to SIMPLE 401(k) Plans or SIMPLE Retirement Accounts remains unchanged at $3,000 (Code section 414(v)(2)(B)(ii)).
- The limitation used in the definition of highly compensated employee remains unchanged at $120,000 (Code section 414(q)(1)(B)).
- The compensation amount used for determining required participation in SEPs remains unchanged at $600 (Code section 408(k)(2)(C)).
- The limitation on the exclusion for elective deferrals to SIMPLE retirement accounts remains unchanged at $12,500 (Code section 408(p)(2)(E)).
- The deductible amount for an individual making qualified retirement contributions remains unchanged at $5,500 (Code section 219(b)(5)(A)).
- The dollar limitation used for the definition of key employee in a top-heavy plan remains unchanged at $170,000. (Code section 416(i)(1)(A)(i)).
- The dollar amount for determining the maximum account balance in an employee stock ownership plan subject to a 5-year distribution period remains unchanged at $1,070,000, while the dollar amount used to determine the lengthening of the 5-year distribution period remains unchanged at $210,000 (Code section 409(o)(1)(C)(ii)).
- The annual compensation limitation for eligible participants in certain governmental plans that, under the plan as in effect on July 1, 1993, allowed cost-of-living adjustments to the compensation limitation under the plan to be taken into account, remains unchanged at $395,000 (Code section 401(a)(17)).
- The monthly limitation regarding the fringe benefit exclusion amount for transportation in a commuter highway vehicle and any transit pass remains unchanged at $130. (Code section 132(f)(2)(A)).

The chart on the following page is a quick reference guide to key limits from 2010 through 2016:

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Key Limits From 2010 Through 2016

	2016	2015	2014	2013	2012	2011	2010
401k/403(b)/457 Elective Deferrals	$18,000	18,000	$17,500	$17,500	$17,000	$16,500	$16,500
Annual Defined Contribution Limit	$53,000	$53,000	$52,000	$51,000	$50,000	$49,000	$49,000
Annual Defined Benefit Limit	$210,000	$210,000	$210,000	$205,000	$200,000	$195,000	$195,000
Annual Compensation Limit	$265,000	$265,000	$260,000	$255,000	$250,000	$245,000	$245,000
Catch-Up Contribution Limit	$6,000	$6,000	$5,500	$5,500	$5,500	$5,500	$5,500
Highly Compensated Employees	$120,000	$120,000	$115,000	$115,000	$115,000	$110,000	$110,000
Top-Heavy Plan Key Employee Compensation	$170,000	$170,000	$170,000	$165,000	$165,000	$160,000	$160,000
Social Security Taxable Wage Base	$118,500	$118,500	$117,000	$113,700	$110,100	$106,800	$106,800

FIRM NEWS

On November 10, **Charlie Storke** will be co-presenter at the International Foundation of Employee Benefit Plans Annual Conference held in Honolulu, Hawaii. Charlie will be presenting on the Multiemployer Pension Reform Act of 2014.

On November 12, **Robert Gower** will be a panelist at a webinar entitled, *Experts' Guide to Employee Benefits Research.* The webinar is sponsored by the Joint Committee on Employee Benefits of the ABA.

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In response to new IRS rules of practice, we inform you that any federal tax information contained in this writing cannot be used for the purpose of avoiding tax-related penalties or promoting, marketing or recommending to another party any tax-related matters in this *Benefits Report*.

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