United Actuarial Services, Inc.
Actuaries and Consultants

2012-56

November 9, 2012

BENEFIT NEWS BRIEFS

7th Circuit Court's EWL Case Reinforces Actuary's Role in Setting Assumptions

The Seventh Circuit Court of Appeals recently upheld a decision in favor of a withdrawing employer regarding the Trustees use of an interest rate assumption that was NOT the "actuary's best estimate of anticipated experience under the plan." The plan used one interest rate assumption for funding calculations and a different interest rate assumption for employer withdrawal liability (EWL) assessments. The withdrawal liability rate caused the withdrawing employer to incur more than $1,000,000 in withdrawal liability than if the Trustees had used the actuary's "best estimate." Actuaries generally use the funding interest rate for EWL.

After receiving the withdrawal liability assessment, the employer sought arbitration, as allowed under the statue. The arbitrator ruled for the employer; the Trustees appealed to the federal district court and lost and then appealed to the Seventh Circuit and lost again. The case is *Chicago Truck Drivers, Helpers And Warehouse Workers Union (Independent) Pension Fund, And Jack Stewart, v. CPC Logistics, Inc., (7th Cir)(August 20, 2012)* and is available by *"clicking here."*

The result is really not surprising as the statute and caselaw establish that the actuary is the one who has the responsibility for setting the actuarial assumptions, in particular the interest rate assumption. Often, the actuary may work with the Trustees to obtain information in order to arrive at an assumption that is the actuary's "best estimate," but in the end the decision belongs to the actuary and not the Trustees.

Several cases have held that where the Trustees substitute their own judgment for the actuary's the withdrawal liability assessment is unreasonable as a matter of law and in such cases the courts have ruled for the employer.

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For example, in *Keith Fulton & Sons, Inc. v. New England Teamsters and Trucking Industry Pension Fund, Inc.,* 762 F.2d 1137, 1141 FN3 (1st Cir. 1985) the court noted:

> It is also worth noting that this calculation is made by an actuary, a professional consultant to the plan, and not by the trustees themselves. **Although the trustees *have the option of accepting or rejecting a given projection*, the trustees' actions with regard to the actuary's estimate can be used in challenging the *reasonableness* of the withdrawal liability calculations.** In *Woodward Sand Co. and Operating Engineers Pension Trust,* 3 E.B.C. (BNA) (Employee Benefits Cases) (Kaufman, Arb.) 2351 (1982), the *plan trustees had rejected the actuary's recommended assumptions* and the arbitrator found the plan's substitute assumptions to be unreasonable. The arbitrator reduced the employer's liability by more than 20% and awarded the employer $10,000 in attorney's fees. (emphasis added)

In *Huber v. Casablanca Indus., Inc.,* 916 F.2d 85, 93 (3d Cir.1990) *cert. dismissed,* 506 U.S. 1088, 113 S.Ct. 1070, 122 L.Ed.2d 497 (1993), the court found the withdrawal liability calculation was not the ***actuary's* best estimate**, because <u>management pressured the actuary to revise initial figures</u>.

The legislative history of the statute is consistent with these court opinions:

> [It is] inappropriate for an employer to substitute his judgment ... for that of a qualified actuary," and "contemplat[ing] that if such a circumstance were to arise *an actuary would have to refuse giving his favorable opinion with regard to the plan*". *Vinson*, *supra* at 1238, citing *see also* H.R.Rep. No. 807, *supra,* at 95, *reprinted in* 2 *Legislative History, supra,* at 3215. (emphasis added)

Nearly identical language regarding the actuary's role in setting the actuarial assumptions, including the interest rate, are also found in the funding section of the Code. The actuary's "best estimate" rules also apply in funding assumptions.

With this background in mind, let us turn our attention to the case at hand.

Although the facts and timeline are somewhat complicated, we will take a big-picture overview and leave it for the interested reader to wade into the details. Different rules apply in different multiemployer industries and Trustees unfamiliar with those rules should look to their actuary and attorney for help in understanding how their industries' particular rules work.

Background to Withdrawal Liability

The Court provided a background to the concept of withdrawal liability noting multiemployer pension plans are governed by *ERISA* and are created by collective bargaining agreements to provide benefits to employees of many different firms. Multiemployer pension plans are found in industries such as construction and trucking in which workers do short-term, seasonal, or irregular work for many different employers over their working lives. The Court continued that when an employer withdraws from such a plan, the plan remains liable to the employees who have vested pension rights, though it no longer can look to the employer to contribute additional funds to cover these obligations.

Rehearsing the legislative background, the Court observed that in an effort to prevent withdrawals that will shift the burden of funding the pension plan to the remaining employers and by doing so, perhaps precipitating additional withdrawals, provisions were added to *ERISA* by the *Multiemployer Pension Plan Amendments Act of 1980* to assess the employer with an exit price equal to its pro rata share of the pension plan's funding shortfall. The shortfall ("unfunded vested benefits" ("UVBs")) is the difference between the present value of the pension fund's assets and the present value of its future obligations to employees covered by the pension plan. (If the present value of the assets exceeds the present value of the plan's future obligations, there is no shortfall.)

In the Court's analysis, it found that estimation of the shortfall depends critically on estimating the amount by which the fund's current assets can be expected to grow by the miracle of compound interest. The higher the estimated rate of growth, the less the employers must put into the fund today to cover the future entitlements of the plan's participants and beneficiaries. The Court noted the impact of the interest rate used has a dramatic impact on associated liabilities.

> "[F]or a typical plan, a change (upward or downward) of 1 percent in the interest assumption (e.g. an increase from 6 to 7 percent) alters the long-run cost estimate by about 25 percent." Dan M. McGill et al., *Fundamentals of Private Pensions* 612 (8th ed. 2005); see also *Artistic Carton v. Paper Industry Union-Management Pension Fund*, 971 F.2d 1346, 1348 (7th Cir. 1992).

The Court continued stating that in addition to estimating the size of the plan's funding shortfall, the pension plan must apportion responsibility for the shortfall among the employers participating in the plan. Each employer must pay his share to the fund if and when he withdraws, so that the plan can pay the employer's share of the plan's unfunded vested benefits as those benefits come due in the future.

The Problem – The Trustees Chose the Interest Rate to Use and It Wasn't the Actuary's "Best Estimate"

The problem arose because the Fund's actuary used one interest rate when calculating UVBs for funding purposes and a different interest rate when calculating withdrawal liability for a withdrawing employer. However, in 1993, the actuary interpreted a Supreme Court decision that the actuary believed raised the question whether it was permissible for an actuary to have one interest rate for calculating the UVB for funding purposes and another rate in calculating the UVB in the withdrawal liability report. The actuary's solution was to suggest that his client Trustees make a decision directing which interest rate to the actuary use.

The gist of the actuary's advice to the client was that the use of different assumptions in the two reports may create litigation risk for the client. The actuary then proposed two solutions for consideration. First, the Trustees could direct the actuary to continue to use the different interest rate for withdrawal liability, which would continue to produce two different numbers for the plan's unfunded vested benefits each year, one for the funding report and one for the withdrawal liability report.

Second, the Trustees could direct the actuary to modify the steps used to determine the UVB for withdrawal liability: first calculate the UVB using the special EWL interest rate and then determine the UVB using the funding assumptions, with the latter setting an upper limit for the UVB. Using the lower number for the UVB each year, the actuary reasoned, would eliminate the risk that an employer would complain that the UVB was too high. The Trustees decided to require the actuary to apply a "cap" to the UVBs used to calculate the withdrawal liability pools from 1996 until 2004.

In 1997, the actuary told the pension plan's Trustees that they could direct the actuary to ignore the different interest rate previously used for withdrawal liability calculations and instead use the interest rate used in funding calculations.

The actuary didn't say the funding interest rate was as good an estimate as its own "best estimate" for withdrawal-liability purposes. The actuary stuck to using a different interest rate for withdrawal liability as its "best estimate." In short, the actuary just said the Trustees could use either of the two rates in calculating the employers' withdrawal liability but did not change its opinion as to which rates were its "best estimate."

In response to the actuary's suggestion, the plan's Trustees directed the actuary to calculate both the funding interest rate and the withdrawal interest rate and then use the higher of the two each year in calculating withdrawal liability. The higher the rate used, the lower the withdrawal liability.

The Court stated:

> "The trustees' decision was questionable. ERISA requires that the computation of withdrawal liability be based on "the *actuary's* best estimate of anticipated experience."

The Court emphasized that the interest rate assumption is supposed to be the actuary's choice since the actuary is a professional, assumed to be neutral and disinterested; a plan's Trustees, in contrast, may, whether for short-term reasons, pressures from employers or unions or lack of relevant expertise, want unreasonably high or unreasonably low interest-rate assumptions.

The Court, in an aside, noted the effects of the interest rate chosen:

> On the one hand, the higher the interest rate assumed, the faster the fund will be predicted to grow and so the smaller will be the liability of withdrawing employers; this in turn may encourage employers to join the plan. On the other hand, the lower the interest rate assumed, the greater the funding shortfall, enabling the plan to impose greater withdrawal liability on any withdrawing employer. That will discourage withdrawals, and also alleviate current funding shortfalls by replenishing the fund with large withdrawal payments by those employers who do withdraw.

In <u>2004</u>, the plan's Trustees directed the actuary to revert to using the withdrawal interest rate to calculate the plan's unfunded vested benefit pools for withdrawal-liability purposes instead of using the higher rate of the two rates as was previously the case. Apparently, the Court noted, the plan's priorities had changed, from attracting more employers with the prospect of low withdrawal liability (by assuming a high interest rate and therefore a rapid growth in the fund's assets) to extracting higher exit prices from employers who withdrew (by assuming a low interest rate and consequently a sluggish rate of asset growth and a larger shortfall).

This decision by the Trustees flew in the face of *ERISA's* requirement the plan's Trustees base its calculation of withdrawal liability on the actuary's "best estimate" and upped the employer's withdrawal liability by over $1,000,000.

The Court emphasized the Trustees were <u>not</u> entitled to disregard *ERISA's* statutory directive that they base their estimate of withdrawal liability on the actuary's "best estimate" of future fund performance. The Court concluded that an actuarial determination that violates *ERISA* by not being based on the actuary's best estimate is unreasonable and rightfully reversible by the arbitrator. The Court upheld the district court which had upheld the arbitrator's decision that the interest rate used was unreasonable as it was NOT the actuary's "best estimate."

A Word About Communicating To A Court (Or An Arbitrator) About EWL

The Court had some unkind words about the briefing of the attorneys on the issue of EWL and said:

> All this [talk of withdrawal liability] was terribly opaque to us because the parties failed to provide context—failed to explain what exactly the pools are, why interest rates are important to withdrawal liability, what the "funding interest assumption" is, [etc]. And so at the oral argument one of the judges felt compelled to ask one of the lawyers, pleadingly, whether she could explain in words of one syllable what the case was about. She was a good lawyer and tried, but, perhaps surprised by the question, failed.

Although superficially witty-sounding, the questioning judge's comment about using "*words of one syllable*" betrays a snarky attitude and an underlying lack of understanding of many things.

It is impossible to speak about "*with-draw-al*" (3 syllables) *li-a-bil-i-ty* (5 syllables) in "*mul-ti-em-ploy-er*" (5 syllables) *pen-sion* (2 syllables) in one syllable words. It is probably impossible to discuss even simple subjects in one syllable words, let alone a complex statue like *ERISA* and the even more arcane subject of multiemployer withdrawal liability.

However, in spite of that criticism of the judge's comments, there is a lesson to be learned by attorneys from Judge Posner's remarks. He stated:

> Hideous complexities lurk in the briefs in this appeal. Many appellate lawyers write briefs and make oral arguments that assume that judges are knowledgeable about every field of law, however specialized. The assumption is incorrect. Federal judges are generalists. Individual judges often have specialized knowledge of a few fields of law, most commonly criminal law and sentencing, civil and criminal procedure, and federal jurisdiction, because these fields generate issues that frequently recur, but sometimes of other fields as well depending on the judge's career before he became a judge or on special interests developed by him since. But the appellate advocate must not count on appellate judges' being intimate with *his* particular legal nook—with its special jargon, its analytical intricacies, its commercial setting, its mysteries. It's difficult for specialists to write other than in jargon, and when they don't realize the difficulty this poses for generalist judges neither do they realize the need to write differently. Federal pension law is a highly specialized field that judges encounter only intermittently. Yet the lawyers in this case made no allowance for our lacking their specialized knowledge.

After the above comment, Judge Posner cited two lengthy sections of the parties' briefs to illustrate his comments and summed them up

> All this was terribly opaque to us because the parties failed to provide context—failed to explain what exactly the pools are, why interest rates are important to withdrawal liability, what the "funding interest assumption" is, and [other peculiarities concerning the two interest rate assumptions].

Counsel briefing before an arbitrator should make sure all these details are spelled out in their arbitration submissions and in all subsequent court briefs. The side that speaks with clarity has an edge over a more technical but opaque argument.

The brief of the *Chicago Truck Drivers, Helpers And Warehouse Workers Union (Independent) Pension Fund* is available by *"clicking here."*

The brief of *CPC Logistics, Inc.,* is available by *"clicking here."*

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