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Proskauer Benefits Brief: Withdrawal Liability “Cheat Codes”: Section 4204

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In this first installment of a two-part conversation, Neil Shah and Rob Projansky unpack one of ERISA’s most talked-about “cheat codes”: Section 4204.

They explain how a properly structured asset sale can avoid triggering withdrawal liability, why the rule exists, and the three core pillars that must be satisfied, including contribution continuity, secondary liability, and bonding requirements. The episode also explores the roles of buyers, sellers, and plans in navigating these transactions, and why careful drafting and timing are critical.

Neil Shah: Welcome to the Proskauer Benefits Brief, legal insight on compensation and benefits. I’m Neil Shah, Senior Counsel at Proskauer. Today we’re diving into one of the various withdrawal liability cheat codes that are in the statute. In the industry, it’s referred to as Section 4204. Why do we call it a cheat code? It’s a statutory provision that, if it’s done right, allows an employer to sell its assets and even shut down its business without triggering any withdrawal liability. To discuss it in detail, I’m joined by Rob Projansky, a partner in Proskauer’s Compensation and Benefits Group. Rob, why don’t you tell us how withdrawal liability comes up in your practice and how Section 4204 fits in?

Rob Projansky: Thanks, Neil. So, I advise buyers, sellers, lenders and plans on multi-employer issues that come up in deals and restructurings. And when you think about multi-employer issues, one of the key risks that comes up that has to be taken into account is withdrawal liability. Anyone listening to Episode 8 of this series already knows that withdrawal liability is an employer’s liability for a share of a plan’s underfunding when it stops contributing to the plan.

So, when companies are engaging in various deals, they of course want to do their diligence to understand the amount of potential liability that they could be facing when they engage in this transaction. But also, a threshold question in deals is making sure that the deal structure itself doesn't turn a potential liability into an actual one. And that's where 4204 comes in. It's a special provision that prevents a sale of assets from triggering the seller's withdrawal from a multi-employer plan by virtue of the transaction itself.

As I'm sure we're going to talk about when you start asking more questions, there are strings attached to this. The buyer has to maintain the contribution obligation, bonds may need to be posted, and there have to be certain assumptions of liability. However, when those boxes are checked, you can execute an asset sale without handing the seller a surprise bill.

So, some of these attached strings are pretty technical in nature, and the consequence of breaking those strings — and I know I'm torturing the string analogy here— but the consequence of breaking them is so severe that we want to be sure we're correctly papering the transaction and taking the steps necessary for this thing to work.

Neil Shah: All right, so that's a helpful overview. Now, why don't you tell us why 4204 matters? What exactly is the problem that the statute is trying to solve here?

Rob Projansky: So, let's start with an easy case, and then we can get to that. So, let's start with a stock sale. Let's say we've got Company A and it's contributing to the plan. And it's, let's say its parent is old parent and old parent sells the stock of Company A to new parent. Okay, that doesn't trigger withdrawal liability because Company A's obligation hasn't changed. Yeah, it has a new owner, but still has its same collective bargaining agreement, and it's still contributing to the plan just like it was before. Nice and easy, no withdrawal.

Okay, now let's turn to an asset sale. Here, instead of selling the stock in Company A, old parent is selling the assets of Company A to new parent, or maybe it's to a new co-subsidiary, but it's the assets that are transferring over and not Company A itself. So, what's important here is that Company A isn't going to be the contributing employer anymore. It's not going to have anything to do with the plan because it's transferring the whole business somewhere else. But since its stock wasn't sold, Company A itself is still owned by old parent. Or maybe it's dissolved, I don't know, but it isn't contributing to the plan anymore. Maybe new parent or new, new co-subsidiary is contributing, but Company A isn't. That's a withdrawal and that triggers withdrawal liability if you didn't have good old 4204.

So, how does 4204 help? You know, at a high level, 4204 is a section of ERISA that provides an exception that's meant to let bona fide arm's-length sales of assets proceed, without the sale itself creating a withdrawal. As long as the buyer steps in and the buyer agrees to contribute for substantially the same level of covered work, and you've met other conditions. That doesn't eliminate potential liability if there's a withdrawal in the future, so if the buyer later stops contributing to the plan for whatever reason, you still have a withdrawal liability. Part of the 4204 requirement is that the buyer takes on five years of contributions from the seller for those purchase operations. So, 4204 isn't a substitute for doing your diligence on the transaction; you still need to understand what you're taking on. But what 4204 does is it says the transaction itself isn't going to cause you to realize that liability immediately.

Neil Shah: So, then it sounds like 4204 offers benefits for both the buyers and the sellers. For sellers, they can sell their assets without triggering a bill for withdrawal liability. And for buyers, they can structure the transaction to purchase select assets and assume only certain liabilities. But, all of this is subject to statutory and regulatory guidelines, and I think you referred to that when you were providing a synopsis of the statute and of 4204 requirement. There's an entire checklist that parties in these transactions tick off. Why don't you tell us some of the most significant ones?

Rob Projansky: You're right. I started to allude to them before, but it probably makes sense to have a little bit of a deep dive here. There's really three pillars that I would say drive 4204.

First, you need a bona fide arm’s length sale of assets to an unrelated party, and that sale has to be the sole cause of the withdrawal. That seems simple enough, but you need to make sure all those pillars are met, including that the parties are unrelated, there are assets moving across and everything is on the up and up, and it’s not just a sham to manipulate the liability.

Second piece, the law is not just going to give you a pass on triggering withdrawal liability, unless it looks like the buyer is going to step into the shoes of the seller in a lot of ways. So, 4204 says that, look, the buyer must be obligated to contribute for substantially the same number of what we call contribution-based units, which is the unit on which contributions are made. So, they’re going to be contributing on substantially the same number of contribution-based units as the seller at the time of the sale. You want to make sure that language is in the transaction documents, or you could have a problem.

Okay, let’s go to the third pillar. The third pillar is really around their wanting to be sure that the arrangement doesn’t leave the plan empty-handed if the seller later withdraws and can’t pay. So, they impose two key conditions. One is that the seller has to agree to be secondarily liable if the buyer later withdraws from the plan in the first five plan years after the transaction and doesn’t pay the liability. But the seller is only liable for the amount up to the withdrawal liability it would have had if the transaction itself triggered the withdrawal. So basically, what they’re saying is, okay, you’re going to be responsible for your share of the withdrawal liability if for some reason the buyer goes out of business or otherwise stops contributing to the plan and doesn’t pay to the plan. You’ll have a piece of it that lingers to make sure the plan’s protected.

The other condition that’s important to protect the plan is bonding. The requirement under 4204 is that the buyer posts a bond that will pay the plan if, during that first five plan years, after the transaction, the buyer withdraws or the buyer’s delinquent in its normal contribution obligation. The amount of that bond is key to the seller’s contribution history. It’s basically the average contribution over the last three years, or if the last year was the highest year, they just used the last year.

What's important here is just to be very conscious of the requirement, because it's super easy to write in an asset purchase agreement that the buyer is going to post a bond, but somebody needs to make sure that it gets done in a timely way. In the transaction documents, both sides often look to allocate responsibility for getting that bond and allocating liability if it doesn't happen. There's a lot of nuances to these roles, including that you can usually post an escrow or a letter of credit instead of a bond if that's easier. There's also something called a variance, which is basically an exception to the requirement to post the bond if the buyer is financially strong, or the bond amount would be de minimis. But for the variance to work, there are certain regulatory timing requirements for the application of the variance that you have to make sure you meet.

By the way, I should mention that it's not just the buyer that has a bonding requirement. A seller can have a bonding requirement as well. If the seller liquidates or distributes substantially all of its assets within that five-year period after the transaction, it actually has to post a bond in addition to the buyer's bond, basically securing its secondary liability. Again, same concept here. They're trying to make sure the plans protected. So, with those three pillars, you can kind of see what they're trying to do. They're trying to ensure continuity and protection for the plan, similar to what you would see if this were a stock deal instead of an asset deal.

Neil Shah: Now, so far, we've been talking about what the buyers and the sellers in these transactions need to do and what they need to pay attention to. What about the plans? What is their role in all of this? Do they need to review something? Do they need to actually approve it after the transaction is over? Is there any monitoring requirement by them? Why don't you tell us a little bit about that?

Rob Projansky: Yeah. So, the plan's on the other side of it, right? So, when it sees that there's a new company contributing or it learns of a transaction, it's going to want to do its homework to verify that the 4204 requirements are met. So, it's going to ask for transaction documents and make sure that all the requisite language is in there about the buyer assuming secondary liability and the obligation to contribute at the same level of contribution-based units. It's going to verify that the buyer's bond is posted on day one of the first plan year after the closing, unless there's a variance. It's obviously going to review any variance requests to make sure it was timely filed and that the transaction qualifies for the variance.

The plan's not going to tell the transaction parties what to do. It's just going to make sure it gets done. Otherwise, it has an obligation to assess withdrawal liability. And look, thereafter, of course, the plan's going to watch for a future withdrawal, and it's going to enforce its rights, including calling on the bond if payments are missed and things like that. Sometimes, plans are asked in advance of the transaction, hey, can you take a look at my 4204 language and make sure that it meets your requirements? Some plans will do that, some plans won't. Some plans will say, sure, we're happy to. Others will say, look, 4204 speaks to itself. It's your obligation to make sure you're satisfying it. That really depends on the plan and their lawyers.

Neil Shah: All right, that's great, Rob. Why don't we stop here? And when you join us next time, we can go through what happens if someone misses one of the important steps to qualify for 4204 and all the horrible things that might happen. And then, some other interesting topics that come up in this area as well.

Rob Projansky: I love leaving this with a cliffhanger, so I'm all for it.

Neil Shah: That's our episode for today. If you found this useful, be sure to follow us and subscribe on Apple Podcasts, Spotify and YouTube so you don't miss the next episode. If you liked what you heard or want to know more, drop us a line at wl@proskauer.com. Today's discussion is for general information and is not legal advice. Thanks for listening to the Proskauer Benefits Brief.

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