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Proskauer Benefits Brief: Withdrawal Liability “Cheat Codes”: Section 4204 (Part Two)

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In the second part of their discussion, Neil Shah and Rob Projansky take a closer look at what happens when a Section 4204 transaction doesn’t go as planned.

Together, they explore how courts interpret the statute’s requirements, the risks that arise when parties miss key steps, and the potential consequences for both buyers and sellers. They also discuss practical strategies for managing these risks, how staged transactions can complicate the analysis, and why parties may choose not to rely on Section 4204 in certain situations.

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 continuing our discussion with Rob Projansky, a partner in Proskauer’s Compensation and Benefits Group, about one of the more important cheat codes in the withdrawal liability statute called 4204.

We covered in our last episode what exactly 4204 is. what the problem is that it’s trying to solve, and some of the more significant requirements that buyers and sellers need to meet in order to make sure that they are able to take advantage of the statutory provision. We concluded our last episode by leaving a cliffhanger. What happens if you fail to satisfy one of the various steps? Either the buyer fails to do it, or the seller fails to do it. What are all the horrible things that could happen?

Rob Projansky: So, that’s a great question, Neil. I think it’s important to note that courts typically construe 4204 safe harbor and lots of other exceptions to withdrawal liability fairly narrowly, so close enough or no harm to the plan arguments. Those typically fail when you’re missing a required element like the contractual secondary liability cause or the posting of timely security.

Let’s talk about timing. We’ve seen PBGC opinion letters, and we’ve seen court cases saying that all of the 4204 requirements have to be met at the time of the transaction. They’ve rejected the idea that you can later cure a deficiency. So, let’s take a case where the seller didn’t assume secondary liability and/or the bond wasn’t posted. Then a year later, they call you up and say, “Oops, listen, we’ll amend the contract. We’ll post the bond.” No harm to the plan, right? The buyer hasn’t withdrawn. Nobody’s hurt by the fact that we didn’t have the bond. Nobody’s hurt by the fact that we didn’t have a secondary liability clause. We’re going to put it in now. It wasn’t triggered anyway before. That should work, right?

Unfortunately, the answer is no. You see these cases out there saying that doesn’t work. Now, I’ve seen situations in which a plan might allow retroactive corrections and said, “Okay, we’ll agree to recognize a 4204 transaction, even if you didn’t meet the requirements, provided you meet them next.” The plan doesn’t have to do that. They’re really doing that as a courtesy.

Now, I’ll say two things about that. First, that’s really a very last resort. You don’t want to rely on the good graces of the plan. The decision makers at a plan have a fiduciary responsibility to collect what’s owed and act solely in the interest of the plan. So, it’s possible that they wouldn’t agree to, to what you’re talking about, absent some compelling reason to conclude it’s in the plan’s interest.

Second, there’s always a possibility that the plan tries to impose additional conditions beyond 4204. So, they’ll say, “Sure, we’ll do this and let you fix it retroactively, but we’ll only do it if you agree to extend the secondary liability period from five years to 10 years or 15 years or forever.” And then you’re at the plan’s mercy because otherwise you’re going to have a withdrawal. So, you don’t want to be in that position. You want to timely meet the requirements so that you don’t blow 4204, and you’re not relying on those good graces.

Let me give you another example where you can't rely on being close to compliance with 4204. Take the requirement that the buyer be obligated to contribute at the same level of CBUs post-transaction. As I said, courts may not let you fix that later if the language is missing from the transaction documents. But here's something even trickier. There have been situations in which the asset purchase agreement has the language about maintaining the CBUs, but then it caveats that language and provides some means for reducing them. That makes sense because the buyer doesn't want to contractually commit to something with the seller. What happens if the business is down for whatever reason? Nobody's fault. It just happens. They don't want to commit to the seller and the contract.

Here's the problem with that. Putting in a caveat like that could blow the whole 4204 transaction up and trigger liability. Because if there's a caveat, there's an argument that the buyer isn't obligated for the same number of CBUs. And 4204 is pretty black and white about that. You have to be obligated for the same contribution base units. The good news is that the obligation should be looked at the time of the transaction. So, if you end up having a future business swing downward, that shouldn't blow up 4204 retroactively.

Neil Shah: All right, so it sounds then like if someone is trying to comply with the 4204 and they make some type of a foot faults, it can have some pretty damaging consequences. Now, from the seller's perspective, the consequences are pretty obvious. It's going to get assessed withdrawal liability when it went through all this effort to satisfy the statute's requirements so that it would not get assessed withdrawal liability. What about the buyer? What does the buyer face other than the fact that, again, it went through all this effort to try to comply with the statute's requirements? What is the buyer facing that might be deemed unintended consequences?

Rob Projansky: Yeah, that's a good question. And I could think of a couple things where that could be an issue. So first is, it really depends what the transaction documents say and the reason for blowing 4204. If, for example, 4204 was blown because the buyer promised to post a bond and didn't, and therefore, the plan doesn't recognize the 4204 and assesses liability against the seller, there may be language in the transaction documents that says that the buyer has to indemnify the seller because it caused that liability that otherwise would have only been a potential liability, now it's realized. So, it really does depend on the reasons that it happens and what the transaction documents say.

So, the second thing that came to mind when you asked the question is the possibility of successor liability. In these asset transactions, oftentimes a plan will say that the buyer is a successor to the seller, and therefore, responsible for the seller's withdrawal liability. So, if the seller sells all of its assets and then for whatever reason can't pay its liability that gets assessed by the plan, the plan may then come looking to the buyer. And there may not be protections in the transaction documents because nobody was expecting that 4204 wasn't going to work. So, those are two examples of where there's some risk even to the buyer if 4204 doesn't go through the way you want.

Neil Shah: All right, now let's say that someone forgets to dot an i or cross a t or make sure that some obligation was actually complied with after the closing. How do — if you're a party to one of these transactions, are there ways to deal with that?

Rob Projansky: Yeah, look, I can think of two ways. First, from a practical perspective, you want to make sure you don't set it and forget it. This is not the Ron Popeil rotisserie chicken maker we're talking about here. You can't just set it and forget it. Look, you certainly want lawyers and others who understand withdrawal liability. You want them working on your transaction documents, but that's just the table stakes. Equally important is understanding what is in those documents and making sure the promises are executed on. So, you have to allocate that responsibility to actually implement things and make sure you don't have these foot faults that you're talking about.

So, the second thing that's important is the allocation of responsibility for not meeting the requirements, which is really what I was alluding to when I was answering your last question. For example, is there an indemnity to the seller if the buyer doesn't post the bond and it ends up causing the seller to incur liability? Are there limitations on the liability in the contract that need to be considered? Perhaps, I guess the simplest way to say it is this, both the allocation of responsibility for action and the liability for the consequences need to be thought about ahead of time. I think those two things, in addition to the practical perspective of making sure you have people doing what they're supposed to be doing, I think in the end of the day, that's how you deal with the foot faults.

Neil Shah: Let's talk about one of the more common situations that come up, mixed sales and stage closings. This is a situation where a company shuts down some operations in one year and then sells the remaining operations a few years later in a 4204 transaction. Or it might sell multiple lines of business in phases. What happens there?

Rob Projansky: Yeah, great question. And actually, one that's harder to answer in black and white. Order and framing is definitely going to matter here, and let me explain what I mean by giving you an example. Let's say you have a situation in which a company stopped some of its operations in one year, stopped a couple more a couple years later, and then engaged in a 4204 transaction a couple years after that. So, if the various shutdowns were for independent reasons, they were responding to different economic conditions, or they were in different plan years. I think most courts would say, "Yeah, you know, the 4204 transaction should apply to that last piece, that last transaction." I'm just saying that the ultimate complete cessation that occurred at the time of the 4204 transaction shouldn't trigger withdrawal under those circumstances.

I can think of other situations in which the framing doesn't work quite that well. So, remember what I said in the last episode? The withdrawal has to be solely because of the asset sale. So, let's change my facts a little. What if this all happened in one plan year? Or here's a better example: what if the group of transactions can be shown to be part of a plan to withdraw on stages? I think if you had a plan to withdraw on stages, I think you're probably looking at 4204 not working and all of this being treated as a complete withdrawal at the time of the last transaction. And the reason is that the plan, and ultimately a court, would likely say that the withdrawal here was not solely because of the asset sale. It was because of the combination of transactions that really weren't independent of each other.

Neil Shah: Rob, in one of our recent episodes with Danny Desatnik from the Firm's restructuring group, we talked about how buying assets out of bankruptcy can still leave a purchaser facing a successor liability claim. Now let's say a buyer purchases assets in a sale that satisfies all of 4204's requirements. What does that mean from the perspective of a potential claim that the buyer is a successor and that it doesn't just inherit five years of contribution history; it inherits all of the contribution history of the seller?

Rob Projansky: There's an argument there in different lanes. A compliant 4204 sale prevents the sale itself from triggering a seller withdrawal. You know, successor liability is a separate doctrine that can reach an asset buyer based on notice and substantial continuity of the business. And courts sometimes decide successor exposure regardless of 4204 compliance, really just looking at the normal things you would look at with successor liability. So, to mitigate that, you know, you want to give direct notice to the plan. You want to avoid continuity where you can in branding, location, workforce, coordinate on union successorship. And if the facts support it, paper your no successor findings in the record. As we covered earlier in the series, I think plans may still pursue successor theories when the facts line up. Obviously, there'll be employers. The buyers will certainly challenge that in a court of law.

Neil Shah: So, let's do a little bit of a recap. 4204 provides an opportunity for sellers to sell their assets without triggering a withdrawal. For buyers who are already contributing to a plan, they can expand their operations while succeeding to some, but not all, of the seller's contribution history, and potentially while avoiding other liabilities. Now, something might get messed up in the transaction or something unexpected may happen after the close.

Rob, what are the types of things that you see parties in these transactions try and do to reduce their risk that something goes wrong with the 4204 transaction, or something unexpected happens after the transaction closes?

Rob Projansky: Yeah, let's — diligence and drafting are going to do most of the work here. On diligence, we want to confirm that the contribution-based units, we want to confirm those and the buyer's operational plan at closing are going to satisfy that — substantially the same standard. On drafting, we include the secondary liability clause in the contract, exactly as the statute says. We build a timeline so that the buyer's bond or escrow is posted as of day one of the first plan year after the close, unless at variance, and we make sure if we are going to go for a variance that it's done on time. We plan for a seller liquidation bond if the seller plans to wind down inside that five-year window.

On the economics, we price residual risks. We use escrows; we use indemnities tailored to that five years' worth of exposure. We calibrate the insurance with realistic expectations, particularly given how rep and warranty carriers treat withdrawal risk.

And finally, we preserve optionality on that variance route. If it makes sense for a financially strong buyer or one with smaller operations, we'll apply for the variance, we'll paper the plan notices and make sure that we get all the responses in on time so there's no friction going forward and we have a nice clean record.

Neil Shah: Now, we've been spending a lot of time talking both that last episode and this current episode about 4204, and all the, the great things that it potentially offers buyers and sellers, and all the horrible things that could happen if you get it wrong. We haven't really answered one other question, which is, we've assumed that 4204 is right for everyone. Are there circumstances in which — parties, it just doesn't make sense for them to engage in a 4204 transaction at all?

Rob Projansky: I think you may have saved the best question for last. You know, we spend all this time talking about 4204, and now we'll talk about why you don't even want it. But sure, it's very easy to assume that 4204 transactions are desired, because if you don't have one, it turns a potential liability into an actual one. And usually, it's in everybody's interest to avoid that. So, you know, we do a long podcast on it.

But I’m glad at the end we’re sort of caveating that a little bit, because there are definitely times when that’s not true. Let’s take a great example. What if the plan has no unfunded vested benefits, meaning that their withdrawal liability of the seller will be zero? Well, why would you go through the mechanics of 4204? Why would you transfer contribution history? Even if the buyer plans to stay in the plan, it can make a lot of sense to let the seller withdraw and let the buyer start fresh. Of course, if you’re skipping 4204 for that reason, you want to be very sure that there’s not going to be any liability. But if you are, it makes total sense not to do a 4204 transaction.

Let’s take another example. Even where there is withdrawal liability, there could be times where a new employer just wants to start fresh. So, it says to the seller, “Hey, I want you to withdraw from the plan. I don’t want to do a 4204 transaction.” In fact, sometimes the seller will even say, “And I want you to pay your liability in a lump sum, so that I don’t have any risk of success or liability.” That happens in transactions because the buyer just wants to start over, you know.

The trade-off there, of course, is that it can reduce the value of the transaction for the seller. That’s somewhat mitigated by the fact that, when you do have a 4204 transaction, sometimes the buyer’s going to seek compensation for the potential liability they’re taking on. In some sense, the value to the seller is already reduced, that compensation is sometimes, for example, in the form of a purchase price reduction or an agreement to indemnify the buyer for some portion of its withdrawal liability if the buyer later withdraws.

So, while 4204 is a very useful tool, and I think our time was well spent on this podcast, I can definitely think of situations in which it wasn’t used, or somebody might not want to use it in the future, because of the dynamic between the seller or the buyer, or the plan and the union.

Neil Shah: Rob, that was great. Thanks so much for joining us for these two episodes to talk about one of the essential cheat codes in the statute, and, as you just mentioned, one that might not be right for everyone.

Rob Projansky: Thanks for having me today.

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 like 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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