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BULLETIN

TO: Pension Plan Clients
FROM: Saltzman & Johnson Law Corporation
DATE: November 1, 2021
RE: Legal update re: Segal Blend

This memo is intended to explain a recent appellate court decision regarding the application of the Segal Blend interest rate assumption used to calculate withdrawal liability. As explained below, the interest rate assumption is the statutory responsibility of a plan actuary and not the Board of Trustees. The Trustees can request information from the plan actuary to consider the impact a different actuarial interest rate assumption has on the plan, whether for withdrawal liability or for other purposes.

Relevant ERISA Provision

ERISA §4213, 29 U.S.C. §1393 states the following:

> (a) USE BY PLAN ACTUARY IN DETERMINING UNFUNDED VESTED BENEFITS OF A PLAN FOR COMPUTING WITHDRAWAL LIABILITY OF EMPLOYER. The corporation may prescribe by regulation actuarial assumptions which may be used by a plan actuary in determining the unfunded vested benefits of a plan for purposes of determining an employer's withdrawal liability under this part. Withdrawal liability under this part shall be determined by each plan on the basis of—
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> (1) actuarial assumptions and methods which, in the aggregate, are reasonable (taking into account the experience of the plan and reasonable expectations) and which, in combination, offer the actuary's *best estimate of anticipated experience under the plan*, or
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> (2) actuarial assumptions and methods set forth in the corporation's regulations for purposes of determining an employer's withdrawal liability.

(Emphasis added). PBGC has not yet proposed regulations providing for the actuarial assumptions and methods that may be used under ERISA §4213(a)(2). In July 2021, the PBGC stated it intended to issue regulations regarding actuarial assumptions used to determine unfunded vested benefits for purposes of calculating an employer's withdrawal liability. Until they issue such proposed regulations, ERISA §4213(a)(1) provides the operative standard.

Under ERISA §4213(a)(1), a plan actuary[1] must use his or her best estimate of the interest rate to be used in calculating withdrawal liability. In order to calculate withdrawal liability, the actuary first determines the difference between the present value of vested benefits and the current value of the plan's assets, resulting in the plan's unfunded vested benefits (UVBs). Withdrawal liability is the withdrawn employer's share of the plan's UVBs. The actuary has different options to determine the interest rate for withdrawal liability purposes. One common approach is to use the same interest rate as the plan's long-term funding assumptions for minimum funding purposes[2] (typically 6.5% - 8%), which results in a *lower* assessment of withdrawal liability than if a lower interest rate had been used. A relatively rare approach is to use the PBGC annuity interest rates (i.e., 2-3%) used to determine the present value of future liabilities for plans terminated by mass withdrawal, which results in a *higher* assessment of withdrawal liability than if a higher interest rate had been used[3].

The Segal Blend

In-between the above two approaches is the so-called Segal Blend, which, in general terms, blends the two different interest rates: (1) PBGC annuity interest rates to the extent the plan has assets; and (2) long-term funding assumptions used for minimum funding purposes to value the portion of the liabilities in excess of the assets. Using the Segal Blend results in an assessment of withdrawal liability between the above two approaches. The Segal Blend, though developed by Segal, is commonly used by other actuarial firms.

Recent Decisions

In recent years, the appropriateness of using an interest rate that is different than the rate used for funding purposes has been contested in district courts, with two cases upholding the use of a rate other than the funding rate. In *Manhattan Ford Lincoln, Inc. v. UAW Local 259 Pension Fund*, 331 F. Supp. 3d 365 (D. N.J. 2018)("Manhattan Ford") the Court upheld use of the Segal Blend. In *UMWA 1974 Pension Plan v. Energy West Mining Co.*, 2020 U.S. Dist. Lexis 90294 (D. D.C. 2020), the Court upheld the use of PBGC rates (this case is currently on appeal). In contrast, two other district court cases have limited the use of an interest rate other than the rate used for funding purposes: *New York Times Co. v. Newspaper & Mail Deliverers'-Publishers' Pension Fund*, 303 F. Supp. 3d 236 (S.D. NY 2018) (the parties settled prior to appeal) and *Sofco Erectors, Inc. v. Trs. of the Ohio Operating Engr's Pension Fund*, 2020 U.S. Dist. Lexis 87774.

In *Manhattan Ford*, the Court noted that the statutory contexts involving the interest rate used for purposes of minimum funding versus the interest rate for purposes of withdrawal liability differ: ERISA §4213 (the withdrawal liability section) requires that the assumptions used to determine the rate be reasonable "in the aggregate," while ERISA §304(c)(3)[4] (the minimum funding section) requires that "each" assumption be reasonable, meaning that each element of the assumption be reasonable. *Manhattan Ford*, 311 F. Supp. 3d at 387. Thus, according to the Court, there was no statutory requirement that the assumptions be the same. As to the issue of whether the fund's actuary used a reasonable assumption in calculating Manhattan Ford's withdrawal liability, the Court found that it was reasonable to use a model such as the Segal Blend because there is value in

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[1] An actuarial determination that violates ERISA by not being based on the actuary's best estimate and instead substitutes the Trustees' own determination is unreasonable and subject to reversal by the arbitrator. *Chicago Truck Drivers, Helpers and Warehouse Workers Union (Independent) Pension Fund v. CPC Logistics, Inc.,* 698 F.3d 346 (7th Cir. 2012).
[2] See ERISA §304(c)(3), 29 U.S.C. 1084(c)(3), and Internal Revenue Code §431, 26 U.S.C. §431(c)(3).
[3] At times in the past, the interest rates used by the PBGC were higher than plan long-term funding assumptions, leading to *lower* withdrawal liability assessments than by using the plan's funding rate.
[4] 29 U.S.C. §1084(c)(3); 26 U.S.C. §431(c)(3).

transferring the risk from the employer to the Fund. *Id*. at 399-400. Further, the Court rejected Manhattan Ford's arguments that the risk-transfer theory is misguided because the risk of overperformance and underperformance were the same. *Id*. at 403. As ERISA is a remedial, pro-employee statute, it is permissible to err on the side of safety for plan participants. *Id*. at 403.

6th Circuit *Sofco Erectors* Decision

The Ohio Operating Engineers Pension Fund ("Ohio Fund") assessed almost a million dollars of withdrawal liability against Sofco Erectors for partial withdrawals followed by a complete withdrawal. *Sofco Erectors*, *Sofco Erectors v. Trs. of the Ohio Operating Engr's Pension Fund*, 2021 U.S. App. Lexis 29279, at 2 (6th Cir. 2021) ("Sofco Erectors"). In arbitration, the arbitrator upheld the use of the Segal Blend, finding it to be the actuary's best estimate. *Id*. at 8-9. The district court reversed the arbitrator, finding that although the interest rate used by the Ohio Fund's actuary to calculate withdrawal liability need not always be the same as that used for minimum funding purposes, the interest rate was unreasonable because it was not the actuary's "best estimate" of the anticipated experience under the plan. *Id*. at 9.

In the 6th Circuit Court of Appeal's decision, Sofco Erectors argued that the interest rate used by the Ohio Fund's actuary to calculate withdrawal liability did not comply with the statute because it was not based on the actuary's "best estimate of anticipated experience under the plan" as required by ERISA §4213. *Id*. at 16. The Court of Appeals agreed. *Id*. at 17. The actuary testified at the arbitration hearing that the PBGC rate is blended into the interest assumption because annuities are purchased to settle up a pension plan facing mass withdrawal. The Court rejected that argument and concluded that using the Segal Blend violates the statute because

> it dilutes the actuary's best estimate with rates on investments that the plan is not required to and might never buy, based on a formula that is not tailored to "the unique characteristics of the plan."… An actuary using the Segal Blend is factoring in an interest rate used for plans that essentially go out of business, even though these plans are neither going out of business nor required to purchase annuities to cover the departing employer's share of vested benefits." *Id*. at 17-18 (citation omitted.) While an actuary may take a conservative approach in selecting the minimum funding rate, factoring in a further discount by blending that rate with the conservative PBGC annuity interest rates after the best estimate has been reached is not appropriate. *See Id*. at 20-21.

The Ohio Fund argued that blending these interest rates is fair because the withdrawal liability payment transfers the investment risk from the withdrawing employer to the pension fund. *Id*. at 21. The Court rejected this argument holding that ERISA did not incorporate a risk-shifting scheme here, as it does for mass withdrawals.

The Ohio Fund also argued that it is accepted actuarial practice to use the Segal Blend. *Id*. at 21-22. Though the Court acknowledged that using the Segal Blend is an accepted actuarial practice, the Court found, in this case, that the actuary must use their "best estimate of anticipated experience under the plan." *Id*. at 22-23.

Finally, Sofco Erectors argued that prior case law forbids the actuary from using one interest rate for minimum funding purposes and another for withdrawal liability. *Id*. at 15. The Court of Appeals declined to decide that question because it found for Sofco Erectors on the narrower question that the interest rate by the Ohio Fund's Actuary did not comply with the statute. *Id*. at 15-16.

Practical Implications

It is important to keep in mind that the *Sofco Erectors* decision is not binding law outside of the 6th Circuit and not binding on plans in the Ninth Circuit. There are no decisions within the Ninth Circuit on this issue. However, as there are relatively few published withdrawal liability decisions that address this issue, attorneys frequently cite, and courts sometimes rely on, out-of-circuit decisions as persuasive authority. The vast majority of arbitrators and courts have accepted the Segal Blend as an acceptable method for calculating withdrawal liability.

The Plan actuary (not the Board of Trustees) is statutorily responsible for determining the plan's funding rate as well as the rate used to calculate withdrawal liability. The amount of the withdrawal liability assessment using the Segal Blend versus the minimum funding rate will vary from plan to plan and will vary within each plan over time, depending on the PBGC interest rates and the amount of the plan's assets compared to its liabilities. For example, in *Manhattan Ford Lincoln* case cited above, a $2.55 million assessment would have been reduced to $0 and in *Energy West Mining* case, a $115 million assessment would have been reduced to about $40 million. *Manhattan Ford Lincoln, supra*, 331 F. Supp. 3d at 375; *Energy West Mining Co.*, 2020 U.S. Dist. Lexis 90294, at *17-18.

As discussed above, the *Energy West Mining* case is currently under appeal in the DC Circuit, so we may soon have another decision to guide us. Additionally, as noted above, PBGC is expected to issue regulations regarding actuarial assumptions used to determine unfunded vested benefits for purposes of calculating an employer's withdrawal liability.