A Practitioner's Guide to

ERISA § 4204
Sale of Assets Bonds

Withdrawal Liability, the Safe Harbor, the Bond, and the Variance

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I. The Problem: Withdrawal Liability Meets the Asset Sale

The Multiemployer Pension Plan Amendments Act of 1980 grafted onto ERISA a rule that every M&A lawyer working in unionized industries eventually meets the hard way: an employer that ceases its obligation to contribute to a multiemployer defined benefit plan — or permanently ceases covered operations — has *withdrawn*, and a withdrawn employer is assessed its allocable share of the plan's unfunded vested benefits under ERISA § 4211. The assessment is calculated by the plan, payable on the plan's schedule, and enforceable through a collection regime tilted heavily in the fund's favor. For a contributing employer in construction, trucking, food distribution or grocery, the number routinely dwarfs the value of the business itself.

An asset sale is the paradigm trigger. The seller stops contributing the day the assets change hands; the cessation is a complete withdrawal; the liability crystallizes. Left there, the rule would make union-shop businesses nearly unsellable as going concerns — no rational seller could absorb the assessment, and no rational buyer would assume it. Congress recognized the problem and drafted a door: Section 4204.

II. The § 4204 Safe Harbor

Section 4204 of ERISA (29 U.S.C. § 1384) provides that a bona fide, arm's-length sale of assets to an unrelated purchaser is **not** a withdrawal — if, and only if, three conditions travel with the transaction. Each must appear in the purchase agreement itself; the safe harbor is a creature of contract drafting as much as of statute.

A. The Contribution Continuation Covenant

The purchaser must have an obligation to contribute to the plan with respect to the operations acquired, for substantially the same number of *contribution base units* for which the seller had an obligation to contribute. The CBU concept — hours worked, tons hauled, whatever metric the collective bargaining agreement uses — is the statute's unit of continuity. A purchaser that intends to shrink the covered work below “substantially the same” level is not a § 4204 purchaser, whatever the documents recite.

B. The Bond or Escrow

For the five plan years commencing with the first plan year beginning after the sale, the purchaser must provide the plan with a bond issued by a corporate surety acceptable under ERISA § 412, or deposit an equivalent amount in escrow with a bank or similar financial institution satisfactory to the plan. The amount is fixed by statute: **the greater of** (i) the seller's average annual contribution to the plan for the three plan years preceding the sale, or (ii) the seller's annual contribution for the last plan year before the sale. If the purchaser withdraws from the plan, or fails to make a required contribution, during those five plan years, the bond is payable to the plan.

C. The Seller's Secondary Liability

The sale contract must provide that if the purchaser withdraws during those five plan years and fails to pay its withdrawal liability, the seller is secondarily liable for the amount the seller would have owed but for § 4204.

The seller has not escaped its exposure; it has subordinated that exposure behind the purchaser's performance and the surety's penal sum — which is why sellers' counsel scrutinize the surety's quality as carefully as purchasers' counsel scrutinize the premium.

Drafting is the whole ballgame

A transaction that closes without conforming § 4204 provisions has not made an imperfect election — it has made no election. The seller's withdrawal is complete, the § 4211 assessment follows, and no post-closing amendment repairs the omission. Before any bond is discussed, confirm the three covenants are actually in the executed agreement.

III. The Bond as an Instrument

The § 4204 bond is a three-party surety instrument of an unusual shape. The **purchaser** is the principal. The **multiemployer plan** is the obligee. The surety guarantees, up to the penal sum, the purchaser's payment obligation if the purchaser withdraws during the five-plan-year period and fails to pay its resulting withdrawal liability. Payment by the surety triggers the ordinary machinery of indemnity and subrogation: the surety recovers from the purchaser and every indemnitor, with interest and costs.

Three features distinguish the instrument from commodity surety paper. **First, the term.** Five plan years, effectively non-cancelable — the surety cannot exit mid-term because the purchaser's credit deteriorates, which is precisely when the exposure is greatest. Underwriting must therefore price the credit as it may become, not merely as it stands at closing. **Second, the obligee.** Multiemployer funds are sophisticated, counsel-driven obligees who frequently prescribe their own bond forms; form negotiation is part of the placement, not an afterthought. **Third, the trigger.** The bond does not answer for ordinary delinquencies alone — it answers for the purchaser's withdrawal and nonpayment, a corporate-event risk that turns on the purchaser's post-closing operating intentions for the covered work.

Multi-Plan Transactions

A seller contributing to several funds produces several instruments: the statute runs plan by plan, each penal sum separately calculated from the seller's contribution history to that plan, each fund a separate obligee with its own form preferences. Coordinated effective dates, a unified indemnity package, and a single renewal calendar are the difference between an administered program and five years of chasing paper.

IV. Calculating the Penal Sum

The statutory formula admits no negotiation: the greater of the seller's last-plan-year contribution or the average of the three preceding plan years. Two practice notes prevent most miscalculations. **Plan years, not fiscal years.** The measurement periods are the plan's years, which frequently do not match either party's fiscal calendar; pull the figures from the plan's own records or the seller's remittance history, not from the seller's general ledger alone. **Growth cuts against you.** A seller whose contributions have grown will be captured by the final-year prong; a seller in decline is captured by the three-year average. Either way the statute takes the larger number, and quoting from the wrong prong is the most common error in early deal models.

Illustration	PY-3	PY-2	PY-1 (last)	3-Yr Avg	Penal Sum
Growing contributor	$760,000	$790,000	$850,000	$800,000	**$850,000**
Declining contributor	$900,000	$700,000	$500,000	$700,000	**$700,000**

V. The Variance: 29 CFR Part 4204

The Pension Benefit Guaranty Corporation's regulation at 29 CFR Part 4204 does something remarkable for a federal rule: it lets the parties excuse the bond themselves. Under § 4204.11, the bond/escrow requirement and the sale-contract secondary-liability provision are not required if the parties inform the plan in writing of their intention that the sale be covered by § 4204 and demonstrate, to the plan's satisfaction, that at least one of the regulation's criteria is met. There are three.

A. The De Minimis Test — § 4204.12

The bond is excused if its amount would not exceed **the lesser of $250,000 or two percent of the average total annual contributions made by all employers to the plan** for the three most recent plan years ending before the date of determination. The test measures the transaction against the fund, not against the parties: a $200,000 bond is de minimis to a fund collecting $40 million a year from its employer base, and immaterial security serves nobody.

B. The Net Income Test — § 4204.13(a)(1)

The bond is excused if the purchaser's average net income after taxes for its three most recent fiscal years — reduced by any interest expense incurred with respect to the sale that is payable in the following fiscal year — **equals or exceeds 150 percent of the bond amount**. Note the leverage adjustment: acquisition debt service comes out of the income figure before the comparison runs, which is exactly where private-equity structures stumble on a test they expected to pass.

C. The Net Tangible Assets Test — § 4204.13(a)(2)

The bond is excused if the purchaser's net tangible assets at the end of the fiscal year preceding the determination **equal or exceed the unfunded vested benefits allocable to the seller** under § 4211 with respect to the purchased operations — or, where the purchaser was already obligated to contribute to the plan before the sale, the sum of the purchaser's and the seller's allocable UVBs. This is the test that makes the § 4211 estimate letter a mandatory diligence document: the comparison cannot run without it. For multi-plan requests, § 4204.13(b) aggregates the bond amounts and UVB figures across the covered plans.

The stale-analysis trap

Every Part 4204 test runs on the purchaser's figures, and in a leveraged transaction the purchaser that exists at signing is not the purchaser that exists at closing. Net tangible assets shrink under acquisition goodwill and debt; net income shrinks under the regulation's own interest-expense adjustment. A variance screen run in early diligence against the pre-deal balance sheet can reach the opposite conclusion from the same screen run against the pro forma. Underwrite — and rely on — the post-closing analysis only.

D. Individual Variances — §§ 4204.21–.22

Where no self-executing criterion is satisfied, Subpart C preserves a petition route: the parties may request a variance or exemption from PBGC itself, which will grant relief where the request demonstrates the transaction poses no significant risk to the plan. The route is real but calendar-hostile — agency process rarely fits an M&A closing timeline — and in practice the petition serves deals with unusual equities and patient parties. For everyone else, the bond is faster than the argument.

VI. Bond Versus Escrow

The statute treats the bond and the escrow as equivalents; treasury management does not. The escrow ties up the full penal sum in cash or cash-equivalents for five plan years — dead capital earning escrow rates while the operating business could deploy it. The bond substitutes a premium measured in basis points of the penal sum for the capital itself, preserving liquidity at the cost of underwriting scrutiny and indemnity. The escrow occasionally wins: a purchaser whose credit prices the bond high, or who cannot stomach the indemnity conversation, may rationally prefer to park the cash. A competent desk prices both structures side by side on every file and recommends in writing. The recommendation is sometimes against its own premium; that is what the recommendation is for.

VII. Underwriting the § 4204 File

The submission that moves in days rather than weeks contains nine documents: the executed or near-final asset purchase agreement with the three covenants; the closing date and deal calendar; the identity of every plan; the seller's three-year contribution history per plan; each plan's most recent Form 5500 and zone-status certification; the § 4211 withdrawal liability estimate; three years of purchaser financial statements plus interim; the pro forma post-closing balance sheet; and the CBA assumption or union consent evidencing continuity of the covered work.

The analysis those documents feed runs in a fixed order. **First, the variance screen** — because a file that exits through Part 4204 should exit before anyone drafts indemnity. **Second, the plan.** Zone status, funding trend, and the size of the seller's allocable UVBs relative to the penal sum define the severity if the bond is ever called; a green-zone fund behind a strategic acquirer and a critical-status fund behind a leveraged platform are different risks at identical penal sums. **Third, the post-closing credit.** The five-year, non-cancelable term means the surety is underwriting the purchaser's balance sheet as the acquisition debt amortizes, not as the pitch deck projects. **Fourth, continuity.** The bond pays when the purchaser withdraws; a buyer whose integration model quietly winds down the union work is the loss scenario, and the CBA assumption, the operating narrative, and the purchaser's history with organized labor are the underwriting evidence on the point.

Structure follows the analysis: corporate indemnity from the purchaser as the baseline; parent or sponsor support, partial collateral, or springing-collateral triggers where the post-closing credit warrants; and, on the strongest files, unsecured terms at rates that reflect the plan-side quality. Private equity sponsors resist fund-level indemnity reflexively, and the conversation belongs at submission rather than at closing — opco indemnity plus collateral versus a sponsor guarantee at a better rate is a solvable equation when it is solved early.

VIII. Administration, Expiry and Release

The instrument outlives the closing binder by five plan years, and the failures in this class are administrative more often than financial: a renewal invoice sent to a deal team that dissolved at closing; a purchaser name change that never reached the bond; a fund demanding evidence of coverage nobody can locate. Assign the bond a home in the purchaser's compliance calendar the week it issues. At the end of the fifth plan year, the seller's secondary liability extinguishes and the bond is released — an event worth papering affirmatively, with confirmation to the fund and closure to the parties, rather than leaving the instrument to linger indefinitely on three sets of books.

IX. Ten Questions for the Closing Checklist

1. Are all three § 4204 covenants in the executed purchase agreement? 2. Has each plan been identified, and does each have its own penal sum calculation from its own contribution history? 3. Which prong — final year or three-year average — drives each penal sum? 4. Has the Part 4204 variance screen been run on *post-closing* figures? 5. Has the § 4211 estimate letter been obtained for the net tangible assets comparison? 6. Has the plan been notified in writing where a variance is claimed? 7. Bond or escrow — has the comparison actually been priced? 8. Has fund counsel prescribed a form, and who is negotiating it? 9. Who holds the indemnity, and does the sponsor know? 10. Whose calendar owns the instrument for the next five plan years?

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Authorities. *ERISA §§ 4201–4225, 29 U.S.C. §§ 1381–1405 (withdrawal liability; § 4204 at 29 U.S.C. § 1384); ERISA § 412, 29 U.S.C. § 1112; 29 CFR Part 4204 (Variances for Sale of Assets), §§ 4204.11–4204.13, 4204.21–4204.22; ERISA § 4211, 29 U.S.C. § 1391. This guide reflects the statute and regulation as in effect at publication; the texts govern over any summary.*

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