Insights, News & Events

THE "E" IS NOT FOR EMPLOYER

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When I speak with employers about the onerous obligations under ERISA and the court decisions that followed, I frequently tell them that the "E" in ERISA stands for "employee," not employer. It's good to keep this in mind when navigating the statute's complexities—especially because courts have frequently found ways to expand ERISA's protections in favor of employee benefit plans. A recent federal appeals court decision highlights this reality, examining some often overlooked areas of the law. While these expansions of the law are not new, this recent opinion provides a good reminder of the current state of the law.

The 6th Circuit, covering Michigan, Ohio, Kentucky, and Tennessee, recently issued its decision in *PBGC vs. Findlay Industries, Inc*. Findlay was a long-standing family business that fell upon hard times in 2009. It had offered a traditional pension plan to its employees since 1964. In 1986, the Company transferred some property to a trust created by its owner. When the company ultimately failed, the CEO—the son of the original owner—created a new company and purchased the assets of Findlay at a substantially discounted price. The CEO then used those assets to start operating two companies substantially similar to Findlay and servicing Findlay's customers.

Faced with assisting a severely underfunded pension plan, the Pension Benefit Guarantee Corporation (PBGC) sued Findlay's former CEO, the trust that owned Findlay's former land, and the CEO's new companies. The PBGC alleged that the trust was a trade or business in the same control group with Findlay and therefore liable for Findlay's obligations to the plan. The PBGC also alleged that the CEO's new

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companies were successors to Findlay, and therefore liable for the predecessors' liabilities.

The lower federal court initially dismissed the claims applicable to the concepts of trade or business, control group, and successor liability. On review, however, the 6th Circuit reversed and adopted a new rule for determining whether an entity is a trade or business (one that had already been adopted in other circuits) and also adopted the concept of successor liability for pension liability (also already followed in other circuits).

This decision highlights a number of lessons for employers and business owners when faced with pension liability. These concepts apply equally to single-employer pension liability as well as liability owed to multiemployer pension plans.

CONTROL GROUP

The concept of businesses being under common control, or a control group or controlled group of corporations, is one that is based on the Internal Revenue Code. This concept links together, for various purposes, businesses that are otherwise separate legal entities. The linking of the businesses together is based upon ownership of the entities.

Determining ownership is a complex process and involves an analysis of direct ownership, attribution of ownership between individuals, attribution of ownership from trusts, and other forms of indirect ownership. After these various rules are applied, the ownership of two or more companies or other entities are compared to see if a common ownership is sufficient for the finding of a control group. If there is the finding of a control group, then the companies are treated as a single employer for purposes of ERISA. This means that one company could be liable for the other's pension liability.

A common question received from employers is whether the companies must be related in the type of business; the answer is no. The control group rules only focus on the ownership of the businesses. Two companies that are in completely unrelated lines of work, in different parts of the country in fact, could be related if the ownership is similar.

TRADE OR BUSINESS

Whether a particular entity must be included in the control group analysis depends upon whether it is considered a trade or business. The 6th Circuit analyzed the district court's decision that focused on ordinary, common sense meaning of the words at issue. "The district court focused on whether the property held in trust was used for business or other commercial activity." The district court found that because the trust was created for the purpose of providing income for family members, it was not a trade or business under ERISA.

The 6th Circuit rejected this determination and instead focused on what is called the "categorical test." The categorical test states that "any entity that leases property to a commonly controlled company is categorically a trade or business for ERISA purposes." This means that the land, previously owned by Findlay and now owned by the trust, was considered to be in common control with Findlay and liable for the pension shortfall. The fact that the trust served other purposes, such as estate planning purposes, did not take it out of the "trade or business" category.

SUCCESSOR LIABILITY

Other circuits, including the 7th Circuit (hearing cases from Illinois, Indiana, and Wisconsin) and the 9th Circuit (hearing cases from most of the west coast, including California, Oregon, Washington, Nevada, Arizona, and others) have recently issued decisions stating that successor companies can be liable for pension liabilities of a predecessor. In deciding the *Findlay* case, the 6th Circuit adopted the federal common law doctrine of successor liability because doing so serves fundamental ERISA policies.

Federal common law can fill in statutory gaps in ERISA when the statute is silent or ambiguous, when there is a gap in the statutory scheme, and when the creation of federal common law is essential to the promotion of fundamental ERISA policies. The court determined that successor liability was appropriate in this case because the CEO, who had knowledge of the pension liability, was able to buy company assets at a discount and use them for future profit-making activity. It further stated that refusing to apply successor liability in this case would frustrate ERISA's policies and

provide incentives to create new exceptions to paying pension liabilities.

LESSONS LEARNED FROM FINDLAY

Although pension attorneys deal with these types of issues all the time, many employers or business owners fail to recognize significant risk when reorganizing businesses. Having a separate company is not sufficient to insulate one from the other's liabilities for ERISA obligations. A family trust, which owns income producing assets, could be considered in a trade or business with other commonly owned businesses, and ultimately liable for pension liabilities. Finally, creating a new business out of an old failed one will not necessarily put an end to liability for a former company's pension plan.

When considering reorganizing a business, whether in distress or not, careful consideration should be made to the form of the reorganization, the owners of the newly reorganized entity, and whether liability can be transferred. Failure to do so could have significant consequences as shown in *Findlay*.

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