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ERISA Successor and Affiliate Liability in Asset Sales and Distressed Benefit Plans

Mitigating Controlled Group and Successor Liability for
Affiliated Companies, M&As, and Corporate Reorganizations

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McGUIREWOODS

ERISA Successor and Affiliate Liability: *Navigating Controlled Group and Successor Liability Rules*

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Overview

- Controlled Group Liability
  - PBGC and Withdrawal Liability Claims
  - Identifying Controlled Group Members
  - Controlled Group Liability of Private Equity Funds
  - Liability of Non-US Controlled Group Members
- Successor Liability
  - Stock Sales, Reorganizations, Spinoffs, and Asset Sales
  - Expanded ERISA Standards of Successor Liability
  - Evade or Avoid Liability and Alter Ego claims
- Due Diligence and Transaction Structure

The Controlled Group Concept

- Under ERISA, certain employee benefit liabilities are a joint and several obligation of the plan sponsor or contributing employer **and** of each member of its "controlled group"
  - Minimum funding, termination liabilities, multiemployer plan withdrawal liability and PBGC premiums
  - The entire amount of the liability may be asserted against each member of the controlled group, but only one satisfaction permitted
  - Controlled group members also have COBRA responsibilities

Controlled Group Pension Liabilities

- PBGC and multiemployer plans are motivated to pursue controlled group members to satisfy unfunded benefit liabilities.
- PBGC's single-employer program guarantees about 24,000 pension plans. Reported $19.3 billion deficit in 2014.
- PBGC's multiemployer program protects about 1,500 multiemployer pension plans (aka Taft-Hartley plans). Vast majority not fully funded for withdrawal liability purposes. Many face insolvency and mass withdrawals. Multiemployer program has 2014 deficit of $42.4 billion and projects insolvency by 2024.
- During FY 2012, PBGC reached settlements with 27 companies for $471 million under ERISA 4062(e) – "downsizing liability."
  - Moratorium on enforcement through December 31, 2014
  - Bill would rewrite the Section 4062(e) rules.

Controlled Group Liability

- Statutory liability that applies to both single-employer and multiemployer plans
- Liability arises without regard to controlled group member's knowledge or intent
- Notice to signatory employer of withdrawal liability constitutes notice to all controlled group members and triggers the time period for raising defenses of all controlled group members.
  - Employers who fail to timely initiate arbitration waive their right to challenge determination and are immediately liable for amount of withdrawal liability demanded

What is a Controlled Group?

- Controlled Group = a group of organizations that is treated as a single employer under the standards of § 414(b) or (c) of the Internal Revenue Code
  - Corporations, partnerships, proprietorships, trusts or estates can all be controlled group members
  - Tax rules allow limited liability companies (LLCs) to elect to be treated as partnerships or as corporations
- Two general sets of standards
  - Controlled group consisting of corporations
  - Controlled group consisting of trades or businesses, whether or nor incorporated

Identifying Corporations in a Controlled Group

- **Method #1 - Parent-subsidiary group**
  - One or more chains of corporations connected through at least 80% stock ownership, by vote or value, with a common parent corporation
  - Example – P Corp is the sole owner of all outstanding stock of S1 Corp and S2 Corp; P, S1 and S2 are all members of a controlled group
- **Method #2 - Brother-sister group**
  - Five or fewer persons who are individuals, estates or trusts
  - Together they own at least 80% of the total vote or value of stock of each of multiple corporations
  - And the sum of their overlapping stock ownership is at least 50%
- **Method #3 - Combined group**

Identifying Organizations that are a Controlled Group

- **Method #1 - Parent-subsidiary group**
  - One or more chains of organizations conducting trades or businesses connected through a "controlling interest"
  - For a trust, 80% actuarial interest (assumes maximum exercise of discretion in favor of beneficiary)
  - For a partnership, 80% capital or profits interest
  - For a sole proprietorship, ownership
  - For a corporation, 80% of total vote or value of all classes
- **Method #2 – Brother-sister group**
  - Same standards as for corporations, using the controlling interest definition above
- **Method #3 - Combined group**

The Trade or Business Condition

- "Trade or business" is not defined by ERISA or regulations
  - Term often used but not defined in Internal Revenue Code
- Supreme Court's test (*Commissioner of Internal Revenue v. Groetzinger,* 480 U.S. 23 (1987)):
  - Must be engaged in an activity for the primary purpose of income or profit, **and**
  - The activity must be conducted with continuity and regularity
- Passive holding of investments not a trade or business
  - Individuals engaged in passive investment were found not to be conducting a trade or business. *Higgins v. Comm'r*, 312 U.S. 212 (1941); *Whipple v. Comm'r,* 373 U.S. 193 (1963)
  - Mere ownership of land is not a trade or business. *Textile Workers Pension Fund v. Oltremare,* 764 F. Supp. 287 (S.D.N.Y. 1989).

Supreme Court and Trade or Business

- Individual with extensive investments, who devoted a considerable portion of his time to managing them, hired others to assist him in managing them, and rented offices for those helping him, was not engaged in a "business" as a matter of law, "[n]o matter how large the estate or how continuous or extended the work required may be." *Higgins* v. *Comm'r*, 312 U.S. 212, 218 (1941).

- *Whipple* v. *Comm'r*, 373 U.S. 193, 202 (1963): "When the only return is that of an investor, the taxpayer has not satisfied his burden of demonstrating that he is engaged in a trade or business since investing is not a trade or business and the return to the taxpayer, though substantially the product of his services, legally arises not from his own trade or business but from that of the corporation."

Trade or Business Under ERISA

- Courts look to the tax code and tax case law to interpret "trade or business"
  - See 29 U.S.C. § 1301(b) (requiring that regulations pursuant to this section be "consistent and coextensive with" regulations under the Tax Code).
- See *also Central States, Se. & Sw. Pension Fund* v. *Fulkerson*, 238 F.3d 891, 895 (7th Cir. 2001).

Application to Private Equity Funds

- Fund – typically structured as a limited partnership
- Investors – limited partners in the fund
- General partner (GP) – typically organized as a limited partnership or LLC
  - May form a separate entity to engage in management activities for the fund
  - General partner or management company selects the businesses in which the fund invests
  - Those businesses may be exposed to minimum funding, plan termination, multiemployer plan and PBGC premium liability
- Key question is whether the Fund itself is a trade or business, such that it could be treated as a part of a controlled group with the businesses in which it invests

PBGC Decision on Private Equity Fund Structure

- 2007 PBGC Appeals Board Decision
  - ruled that a private equity fund is a trade or business and was therefore jointly and severally liable for the unfunded benefit liabilities of a pension plan sponsored by one of its portfolio companies
- PBGC's rationale:
  1. GP of Fund was an agent of the Fund (had control under the Fund's partnership agreement over the Fund's affairs)
  2. Fund met the general test for being a trade or business
     a) GP's ability to receive compensation for its management activities on behalf of the Fund showed a profit motive
     b) Size of the Fund's portfolio and fees paid to the GP showed a regularity of investment activity
  3. Authorities regarding passive investment activity not applicable (involved individuals, no agent involved)

Board of Trustees, Sheet Metal Workers v. Palladium Partners

- 722 F. Supp. 2d 854 (E.D. Mich. 2010)
  - denied summary judgment motion of limited partnerships and private equity firm for withdrawal liability as owners of a bankrupt company.
  - Multiemployer plan argued that that these entities were liable as controlled group members, partners, joint venturers, and/or alter egos.
  - Case settled before trial.

Sun Capital Partners v. New England Teamsters Fund, 724 F. 3d (1st Cir. 2013), cert. denied (2014)

- Ruled that private equity funds can be "trades or businesses" in controlled group liable for withdrawal liability of its portfolio companies.
- *Higgins* and *Whipple* interpreted "trade or business" to determine tax deductibility of expenses. Not controlling when determining controlled-group for withdrawal liability.
- Followed PBGC's fact specific "investment plus" analysis to find that one of the Sun Funds was a trade or business and to remand for further analysis with respect to another fund:
  - Does entity's activity have primary purposes of income or profit?
  - Is activity conducted with continuity or regularity?
- Focused on
  - Size of the fund and its profits
  - Management fees paid to the fund's general partner
  - Advisory services provided and fees received
  - Fund's controlling stake in the operating company

Sun Capital Partners III, LP v. New England Teamsters Fund, No. 10-10921-DPW, 2016 U.S. Dist. LEXIS 40254 (D. Mass. March 28, 2016)

- District Court found that Fund III and Fund IV were each a trade or business
  - Utilized "investment plus" analysis set forth by the 1st Circuit
  - Focused on management fee offsets and carry-forwards
- Once the trade or business test was satisfied, ownership was the last potential obstacle to finding a controlled group

Sun Capital Partners III, LP v. New England Teamsters Fund

- Fund III owned 30% of operating company, Fund IV owned 70% of operating company
- District Court looked to federal tax law and found that the two entities had created a partnership-in-fact
  - Investment and other business decisions were made pursuant to the advice of the management company;
  - Operating in a similar fashion and organization documents were almost identical;
  - Pattern of coinvestment and no outside investors; and
  - No evidence of disagreements over management or operation of the operating company.

Sun Capital Partners III, LP v. New England Teamsters Fund

- District Court also found the partnership between Fund III and Fund IV was a trade or business
  - Management fee offsets and carry-forwards again cited
- Result: Fund III and Fund IV partnership was a trade or business that owned 100% of the operating company
  - Joint and several liability for operating company's withdrawal liability

Sun Capital – Observations & Implications

- Common use of management fee offset arrangements
  - LPs often driver of these arrangements
- Affiliated funds / parallel investing
  - Offshore funds
- Application to single-employer pension plans
- Risk for affiliated operating companies
  - Lending issues should be considered
- Minimum coverage testing
- Venture Capital Operating Companies
  - Management rights letter requirement could be used to satisfy "investment plus" standard

Withdrawal Liability

- A withdrawing employer is liable to the pension plan for employer's share of plan's unfunded vested benefits, if any; determination of UVBs depends on actuarial assumptions and methodologies.
- Withdrawal can be triggered by any significant reduction in the duty to contribute, including layoffs, plant closures, sales, or changes in the bargaining agreement.
- Special rules under ERISA § 4203 for certain industries, including construction, entertainment, retail food, trucking, and coal.

Withdrawal Liability and Controlled Groups

- All "trades or businesses" under common control are treated as a single "employer" and are jointly and severally liable for withdrawal liability of any controlled group member.

- Section 4001(b)(1) of ERISA: "Under regulations prescribed by [PBGC], all employees of trades or business (whether or not incorporated) which are under common control shall be treated as employed by a single employer and all such trades and businesses as a single employer. [Such] regulations . . . shall be consistent and coextensive with regulations prescribed for similar purposes by the Secretary of the Treasury under Section 414(c) of the [tax code]."

- Under "controlled group" rules, if several members of a controlled group contribute to the same multiemployer plan, when one member stops contributing, there may be no withdrawal, or at most a partial withdrawal.

- If one member of the controlled group withdraws, all members have joint and several liability and must timely exercise their rights to challenge the assessment of liability.

Avoiding Seller's Withdrawal Liability in Asset Sale

- ERISA 4204 requires "a bona fide, arm's length sale of assets to an unrelated party"
- Purchaser must have an obligation to contribute for substantially the same number of contribution base units and must timely post a bond for five years (unless exemption applies)
- Seller must agree, in the sale contract, to secondary liability in the event buyer defaults within five years
- Seller also must post bond or escrow in the event of liquidation or distribution of substantially all assets within the five year period
- In a properly executed 4204 asset sale, the buyer effectively assumes the seller's contribution history.

Controlled Group Traps for the Unwary

- In general, there is no individual shareholder responsibility for withdrawal liability.
- However, if individual owner of corporation that withdraws from multiemployer fund also reports Schedule C income from real estate investment property, multiemployer plans have claimed that the shareholder's income from real estate constitutes a "trade or business," making him personally liable for withdrawal liability.
  - *I*.e., a brother-sister group of trades or businesses, the corporation and sole proprietorship, under shareholder's common control.

On What Date Is Controlled Group Determined for Liability Purposes?

- For single-employer plan unfunded benefit liabilities: look to date of plan termination.
  - If agreement not reached between PBGC and plan administrator, the date established by the district court. *See* section 4048(a)(3).
  - This date can be a matter of considerable dispute.
- For multiemployer withdrawal liability, look to date of withdrawal.
  - *Trucking Employees of NJ Welfare Fund v Bellezza Co.*, 57 Fed. Appx. 972, 2003 W.L. 262505 (3rd Cir. Feb. 6, 2003)

Controlled Group Liability Disputes

- Generally disputes over withdrawal liability must be resolved in arbitration.
- BUT the majority of courts have ruled that disputes over whether an entity was ever a member of the controlled group for withdrawal liability purposes are for the court to determine. See *Rheem Mfg. Co. v. Central States*, 63 F.2d; *Connors v. Incoal, Inc.*, 995 F.2d 245, 250-51 & n.6 (DC Cir. 1993); *Central States Pension Fund v. Personnel, Inc.*, 974 F.2d 789, 794 (7th Cir. 1992); *Central States Fund v. Slotky*, 956 F.2d 1369,1374 (7th Cir. 1992).
- For single employer plans, PBGC often pursues alleged controlled group members administratively, subject to PBGC Appeals Board review, and judicial review.

Controlled Group Members Outside the U.S.

- PBGC has asserted "alter ego" doctrine as a basis for recovery against controlled group members outside of United States.
- PBGC takes the position that controlled group liability is extra-territorial. PBGC Opinion Letter 97-1 (May 5, 1997).
- U.S. court jurisdiction over non-U.S. company moots issue of extraterritoriality
- Rejection of claim if minimum contacts do not exist in the U.S. – GCIU-Employer Ret. Fund v. Goldfarb Corp., 565 F.3d 1019 (7th Cir. 2009)

Controlled Group Members Outside the U.S.

- "The PBGC's position is that controlled group liability does extend to foreign entities. While the PBGC has difficulty in collecting on that liability, it has had success in several situations, including cases in which the foreign affiliate (1) has assets in the United States (such as sale proceeds or debts owed to it from U.S. subsidiaries) or (2) has provided collateral to the plan (e.g., to enable the U.S. affiliate to receive a funding waiver related to the plan)."

See American Bar Association, Joint Committee on Employee Benefits, Q&A Session with PBGC (May 7, 2008), available at **http://www.abanet.org/jceb/2008/PBGC2008.pdf**

Central States, Southeast & Southwest Areas Pension Fund v. Reimer Express World Corp., 230 F.3d 934 (7th Cir. 2000)

- Multiemployer pension fund attempted to assert controlled group liability against a foreign parent of the plan sponsor. Court held that "constitutional due process requires that personal jurisdiction cannot be premised on corporate affiliation or stock ownership alone where corporate formalities are substantially observed and the parent does not exercise an unusually high degree of control over the subsidiary." 230 F.3d at 943 (collecting cases).
- Court rejected the multiemployer plan's argument that ERISA's controlled group provisions altered this "general rule" of jurisdiction simply because the controlled group provisions "state[] that all businesses under common control shall be treated as a single entity." *Id.*

Controlled Group Members Outside the U.S.

- PBGC has filed federal liens against non-U.S. controlled group members with the Recorder of Deeds of the District of Columbia, following the procedure for filing a tax lien on personal property of a taxpayer outside the U.S. IRC § 6323(f).
- In general, a corporation "doing business" in the U.S. becomes subject to the jurisdiction of U.S. courts. But, a parent-subsidiary relationship, without more, is insufficient to give U.S. courts jurisdiction over a foreign corporation.
  - See *Central States, Southeast & Southwest Areas Pension Fund v. Reimer Express World Corp.*, 230 F.3d 934, 939, 944 (7th Cir. 2000); *Koken v. Pension Benefit Guar. Corp.*, 430 F. Supp. 2d 493, 500 (E.D. Pa. 2006); see *also Keeton v. Hustler Magazine, Inc.*, 465 U.S. 770, 781 (1984) ("…nor does jurisdiction over a parent corporation automatically establish jurisdiction over a wholly owned subsidiary").

Koken v. Pension Benefit Guar. Corp., 430 F. Supp. 2d 493 (E.D. Pa. 2006)

- PBGC asserted controlled group liability against a British company that acquired stock of U.S. corporation, a subsidiary of which sponsored the pension plan. PBGC argued that British parent's contacts were sufficient because stock purchase agreement "could not have been executed without the approval of a Pennsylvania court [and] because the Guarantee [that accompanied the stock purchase agreement] provides that the validity, interpretation, and enforcement of the Guarantee, as well as any dispute between [the former parent of the U.S. subsidiary being sold] and [the British parent], be litigated in Pennsylvania, under Pennsylvania law." 430 F. Supp. 2d at 500.
- Court concluded that the British parent lacked minimum contacts with the forum to support personal jurisdiction because PBGC's evidence did not show that British parent had "purposefully directed its activities at the forum and purposefully availed itself of the privilege of conducting activities within the forum." *Id.* at 500.

PBGC v. Asahi Tec Corp., No. 10-cv-01936 (D.D.C. March 14, 2012)

- District Court Order: "The Court finds that plaintiff has made a prima facie showing that defendant purposefully directed activity towards the United States in connection with the acquisition of Metaldyne and the attendant assumption of controlled group pension liability, and that the claims in the complaint arise directly out of that specific conduct."
- Petition for interlocutory appeal denied by D.C. Circuit.
- In November 2014 settlement, Asahi Tec paid $39.5 M.

In re Nortel Networks, Inc., 669 F.3d 128 (3d Cir. 2011), *cert. denied* (June 25, 2012)

- Court held that bankruptcy stay bars United Kingdom regulatory action against US affiliates in bankruptcy to address a $3 billion funding deficit in Nortel's UK pension.
- "Once the Appellants subjected themselves to the jurisdiction of the Bankruptcy Courts by filing their claims, they became subject to the provisions of the automatic stay." *Id* at 143.
- Trustee of Nortel's UK Pension Plan unsuccessfully argued that the Third Circuit's decision was "at odds with established notions of international comity, which counsel against US courts issuing orders that unnecessarily interfere with the rights of a foreign sovereign."

Successor Liability in Mergers, Consolidations, or Divisions

- Generally, a multiemployer plan withdrawal will not occur solely because of changes in corporate structure. ERISA §§ 4218.
- Single-employer liabilities generally follow the successors in corporate reorganizations. ERISA § 4069(b).
- *Teamsters Pension Trust Fund of Phila. & Vicinity v. Littlejohn*, 155 F.3d 206 (3d Cir. 1998) - imposition of successor liability in context of a merger, even where successor did not have notice of the liability.
- *CenTra Inc. v. Central States Se. and Sw. Areas Pension Fund*, 578 F.3d 592 (7th Cir. 2009) - a reorganized corporation "inherited" the contribution histories of its old subsidiaries for purposes of determining withdrawal liability.

Spinoffs: *Teamsters Pension Trust Fund of Philadelphia and Vicinity v. Central Michigan Trucking, Inc.*, 857 F.2d 1107 (6th Cir., 1988).

- Fuqua, parent of subsidiary Interstate, distributed all stock of Interstate to shareholders of Fuqua.
- Before and after spin-off, Interstate contributed to a Teamster Pension Fund. Interstate went bankrupt.
- Fund assessed Fuqua for Interstate's withdrawal liability before the 1980 spin-off.
- Sixth Circuit held that the spin-off was a change in corporate structure under ERISA Section 4218. Fuqua was not responsible for any of the withdrawal liability to the Fund.
- Sixth Circuit's analysis is consistent with PBGC Opinion Letter 92-1

Spinoffs: *Central States, Southeast and Southwest Areas Pension Fund v. The Sherwin-Williams Company*, 71 F3d 1338 (7th Circ., 1995),

- Ruled that sale of the stock of a subsidiary where the parent had a continuing obligation to contribute to the same fund did not constitute a complete withdrawal.
- Court reasoned that ERISA Section 4218 did not apply, but, based on ERISA Section 4001(b)(1) ("all such trades or businesses [under common control shall be treated a single employer") and corporate law principles, no complete withdrawal occurred since other members of the group continued contributions to the fund.
- Not clear how the court would have ruled if the former controlled group did not have a continuing contribution obligation to the fund.

Successor Liability in Asset Sales

- As a general rule, an asset purchaser does not assume the liabilities of the seller, with exceptions, *e.g.*, express or implicit assumption. PBGC Opinion Letter 78-10.
- BUT purchaser of assets may have successor liability for delinquent multiemployer plan contributions or withdrawal liability where there is sufficient continuity of operations and the alleged successor had notice of the liability. *Upholsterers' Int'l Union Pension Fund v. Artistic Furniture*, 920 F.3d 1323 (7th Cir. 1990)
- The Seventh Circuit has held that a Chapter 7 liquidation proceeding was not a per se bar to successor liability for withdrawal liability. Court denied the new company's motion to dismiss on the theory that the Fund could recover if the successor had notice of the withdrawal liability claim before acquiring the old company's assets and there was substantial continuity in the operation of the business. *Chicago Truck Drivers, Helpers & Warehouse Workers Union (Indep.) Pension Fund v. Tasemkin, Inc.*, 59 F.3d 48 (7th Cir. Ill. 1995)

Successor Liability in Asset Sales

- *Einhorn v. Ruberton Construction Co.*, 632 F.3d 89 (3d Cir. 2011) followed *Artistic Furniture* to permit successor liability to multiemployer plan contributions where there was sufficient continuity of operations and notice of the liability.
- *But see Boland v. Thermal Specialties Inc.*, 55 EBC 2729 (D. D.C. June 19, 2013) Purchaser was not liable for seller's multiemployer pension fund obligations even though substantial overlap existed in management, business, purpose, operations, equipment, and customers. Purchaser and seller had different ownership and engaged in protracted and arms-length negotiations with legitimate business purpose. (Rejecting alter ego theory and not discussing *Einhorn).*

Sullivan v. Running Waters Irrigation, Inc., 739 F.3d 354 (7th Cir. 2014)

- Multiemployer Fund obtained judgment against Alpine for unpaid pension contributions, then moved to substitute Running Waters and JV as proper defendants.
- District Court determined that Running Waters and JV were successors to Alpine and substituted them as judgment debtors under FRCP 25.
- Running Waters and JV were established upon Alpine's closing and hired Alpine's employees.
- One owner controlled all three entities, who operated out of same location.
- Substantial overlap in customer lists.

Sullivan v. Running Waters Irrigation,

- Seventh Circuit affirmed relying on *Artistic Furniture*.
- No evidentiary hearing required. Defendants failed to request hearing and failed to show what evidence they would have introduced to rebut successorship.
- This exception "developed in the context of ERISA actions . . . to recover delinquent pension fund contributions." 739 F.3d at 357.
- "The ERISA test specifically allows the [Fund] to proceed against the purchaser of the violator's business , even if it's a true sale, provided that two conditions are satisfied: 1) the successor had notice of the claim before the acquisition and 2) there is substantial continuity of operation of the business before and after the sale."

Chicago Reg'l Council of Carpenters Pension Fund v. Longshore/Daly, Inc. 2014 U.S. Dist. LEXIS 23844 (N.D. Ill. Feb. 25, 2014)

- Distinguishes *Sullivan*: FRCP Rule 25(c) motion denied, but limited discovery permitted.
- Alleged successor's prior notice of predecessor's liability was undisputed.
- No successorship because
  - No transfer of assets from predecessor to alleged "successor."
  - Ownership overlap and use of the same phone and address do not establish continuity of operations.
  - Alleged successor established eight years before demise of predecessor.
  - Companies shared only small fraction of customers and handful of employees.

Successor Liability in Asset Sales – 7th Cir.

- *Tsareff v. Manweb Services, 794 F.3rd 841 (7th Cir. 2015)* Court of Appeals found successor liability based on the following:
  1) Notice of claim before the acquisition;
  2) Substantial continuity in the operation of the business after sale; and
  3) Equitable considerations dictate liability should be found on the successor.

- Employer could have protected itself by insisting on price reduction or promise by the Seller to indemnify the buyer against withdrawal liability.
- Remanded to district court for determination of the second factor.

Successor Liability in Asset Sales - 9th Cir.

- *Resilient Floor Covering Pension Trust Fund Board of Trustees v. Michael's Floor Covering, Inc.*, Case No. 12-17675, 2015 WL 5295091, found successor liability on substantial continuity between old and new business based on following factors:
  - Continuity in workforce and business
  - Same customers
  - Same working conditions, location
  - Same supervisors
  - Same products or services produced
  - Same production methods
  - Whether successor is required to bargain with the same union
  - Any change in business that could have affected employee

Transactions to Evade or Avoid Withdrawal Liability

- ERISA § 4212(c) provides:
  - "If a principal purpose of any transaction is to evade or avoid liability under [the provisions governing employer withdrawals from multi-employer plans, those provisions] shall be applied (and liability shall be determined and collected) without regard to such transaction."
  - For single-employer plans, ERISA § 4069(a) (transaction must become effective within 5 years before plan termination).
- Test for disregarding a transaction:
  - Was a principal purpose to evade or avoid withdrawal liability?
  - The transaction need not be a sham or constitute fraud
  - See *Santa Fe Pacific Corporation v. Central States S.E. & S.W. Area Pension Fund*, 22 F.3d 725, 727 (7th Cir. 1994) ("It needn't be the only purpose; it need only have been one of the factors that weighed heavily in the Seller's thinking") Sale of stock disregarded where the principal purpose was to avoid withdrawal liability.

Transactions to Evade or Avoid Withdrawal Liability

- Can cover otherwise bona-fide, arms-length transactions. *See e.g., SuperValu, Inc. v. Bd of Trustees of S.W. Pa. and W. Md. Teamsters & Employers Pension Fund*, 500 F3d 334 (3rd Cir. 2007)(Section 4212(c) applied to CBA where the union understood, and agreed with, company's goal of avoiding liability).
- Where § 4212(c) applies, the transaction in question must be disregarded in determining withdrawal liability
- Courts have allowed the assertion of liability against non-employers under this provision. See *IUE AFL-CIO Pension Fund v. Herrmann*, 9 F.3d 1049 (2d Cir. 1993)(assets transferred by an agreement that violates §4212(c) are recoverable from transferee).
- *PBGC v. White Consolidated Indus.*, 215 F.3d 407 (3d Cir. 2000), company engaged in an evasion by transferring underfunded plans in a highly-leveraged buyout.

Transactions to Avoid or Evade Withdrawal Liability

- *Teamsters Joint Council No. 83 of the Virginia Pension Fund v. Empire Beef Co., Inc.*, 2011 WL 201492, 50 EBC 1824 (E.D.Va. Jan. 20, 2011), on remand from the 4th Circuit, reviewed whether defendant's transfer of property to a creditor was a transaction for which a principal purpose was the evading or avoiding of withdrawal liability.
- Single shareholder corporation transferred its interest in a general partnership to one creditor in exchange for cancellation of $1.3 million loan. Purpose of the transfer was protection against unsecured creditors, including withdrawal liability.
- The court held that a principal purpose of the transfer was not to evade or avoid withdrawal liability, but to protect against all creditors, some of whom were owed more than the pension plan.

Transactions to Evade or Avoid Withdrawal Liability

- *LoPresti v. Pace Press, Inc., et al.*, 2011 WL 2150458 (S.D.N.Y. May 31, 2011): Defendant purchaser's asset purchase agreement did not address buyer's withdrawal liability. Court held that although the parties' agreement did not satisfy ERISA 4204 requirements, this did not bar the plan's "evade or avoid" claim against the purchaser.
- *Einhorn v. Twentieth Century Refuse Removal Company*, 2011 WL 6779760 (D.N.J. Dec. 22, 2011). Court held that fund to sue principal owners of defunct corporation following its sale of assets under an "evade or avoid" ERISA § 4212(c) theory and that fund adequately pled elements of a claim for equitable subrogation or constructive trust under ERISA 502(a)(3).

Alter Ego Liability

- *Retirement Plan of UNITE HERE National Retirement Fund v. Kombassan Holdings*, 629 F.3d 282 (2d Cir. 2010) commonality of control and business purpose between corporation and other contributing employer to pension plan.
- *Board of Trustees, Sheet Metal Workers v. Palladium Partners*, 722 F. Supp. 2d 854 (E.D. Mich. 2010)
- Factors may include degree of overlap in management, business purpose, operation, equipment, customers, supervision, and ownership
- *Resilient Floor Covering Pen. Fund v. M&M Install.*, 630 F.3d 848 (9th Cir. 2010) asked district court on remand to consider whether "evade or avoid" liability of ERISA 4212(c) is sole means of redress.

Alter Ego Liability

- Should apply only where the separate entity structure is disregarded by the entities themselves such that there is no real distinction between them.
- At least one court has rejected extension of alter ego theory to apply to a trade or business under common control with a contributing employer. *Government Dev. Bank for Puerto Rico v. Holt Marine Terminal*, No. 02-7825, 2011 WL 1135944 (E.D. Pa. Mar. 24, 2011)

Beyond Qualified Plans – Top Hat Plans

- In more limited circumstances courts have applied successor liability concepts to executive retirement plans ("top hat" plans)
- *Brend v. Sames Corp.*, 2002 WL 1488877 (N.D. Ill. 2002) - A federal district court held that a company purchasing the assets of a business could become responsible for top hat plan liabilities
  - Purchase agreement specifically provided that these liabilities would not be assumed by the buyer
  - Court did not distinguish top hat plans from other ERISA retirement plans
  - Applied the notice and substantial continuity test

Beyond Qualified Plans – Top Hat Plans

- *Feinberg v. RM Acquisition, LLC* (629 F.3d 671) Court did not impose that top hat plan liabilities on a purchaser of assets because the purchaser had not (i) formally assumed the liabilities, (ii) connived to deprive plan participants of their benefits, or (iii) the plaintiff did not show that the buyer was a mere continuation of the seller
  - Decision recites *Artistic Furniture* standards for applying successor liability

Beyond Qualified Plans – Retiree Welfare Benefits

- Courts have also applied successor liability doctrines to retiree health obligations under ERISA welfare plans – notice and continuity of operations often key factors
- *Grimm v. Healthmont, Inc.*, 2002 WL 31549095 (D. Or., 2002) Oregon District Court extended liability for union negotiated retiree medical benefits to a purchaser of assets
  - Purchasers is a successor employer "if it hires most of its employees from the previous employer's workforce and conducts essentially the same business as the predecessor without a fundamental change in working conditions"

Beyond Qualified Plans – Retiree Welfare Benefits

- *Bish, et. Al., v. Aquarion Services Co., et. al.*, 289 F. Supp 2d 134 (D. Conn., 2003) Court rejected successor employer's motion to dismiss claims for retiree medical benefits under successor liability theory
  - US Filter employees had a CBA to provide waste water treatment services
  - Aquarion enterred into a contract to provide these services and hired employees of US Filter – sent letters to US Filter indicating no disruption in pension benefits, but did not mention retiree medical benefits
  - Court found that successor liability has been recognized in similar instances and that dismissal was not appropriate

Beyond Qualified Plans – Retiree Welfare Benefits

- *Schilling v. Interim Healthcare of Upper Valley, Inc.*, 44 EBC 1988 (S.D. Ohio 2008) Court held that under Artistic Furniture test, buyer was liable for unpaid medical claims under an ERISA health plan
- *Bender v. Newell Window Furnishing Inc.*, 681 F. 3d 253 (6th Cir. 2012) Circuit Court upheld trial court decision that purchaser of window manufacturing plan is liable as a successor under collective bargaining agreements for retiree medical benefits

Transaction Considerations

- Given successor liability case law what are the key considerations for buyers / acquirers:
  - Due diligence process
  - Structuring options
    - Acquisitions of entire organizations
    - Acquisitions of a portion of an organization
  - How to craft the transaction agreement

Due Diligence: Successor Liability Recap

- Successor liability in general:
  - Stock Sale – Buyer will be responsible for seller's benefit plan liabilities
  - Merger – Acquirer will be responsible for target's benefit plan liabilities
  - Asset Sale – Potential transfer of seller's benefit plan liabilities

Due Diligence: Transaction Type

- Stock Sales and Mergers
  - Clear need to perform due diligence seller's / target's benefit plans since liabilities will transfer to buyer / acquirer
- Asset Sales
  - Temptation to skip due diligence based on the belief that there is no successor liability
  - Can a buyer simply "diligence through representations"

Due Diligence: Asset purchases

- Asset purchase transaction due diligence is still important
  - Significant and often ignored body of case law assigning successor liability to purchasers of assets
  - As funding continues to erode, multiemployer plans will likely continue to aggressively assert successor liability claims
  - PBGC likely to pursue similar positions with respect to single-employer plans
  - Courts seem willing to entertain successor liability claims by sympathetic plaintiffs
  - Courts have also found successor liability in the context of other types of ERISA plans (top hat plans and retiree medical plans)

Due Diligence: Practical Considerations

- Practical reason for due diligence
  - Applies to all types of transactions (stock sales, mergers, asset purchases)
- Buyer / acquirer often assumes significant or all of the seller's / target's workforce
  - Employee benefit plan problems can cause headaches for buyers / acquirers even absent a successor liability claim
    - E.g., Code Section 409A violations with seller's executive retirement plan
    - E.g., 401(k) plan disqualification

Due Diligence: Ostrich Approach to Asset Deals?

- Tension between successor liability case law and need to perform due diligence in asset purchase transactions
- Case law looks at (1) continuity of operations, and (2) knowledge of obligations
- Take the "ostrich approach" ?
  - Asset purchase will involve other legal and financial due diligence
  - Disclosure of benefit plan liabilities in some fashion likely
  - Better practice for specialists to be involved in the process to avoid inadvertent overlooking of key benefits due diligence

Due Diligence: Transaction Structuring Considerations

- Additional considerations – potential impact on deal structure
  - Transaction structure usually not driven by employee benefits concerns
  - However, uncovering of significant benefit plan liabilities may lead a buyer / acquirer to favor one structure over another
  - Also may have an impact on transaction document provisions, as will be discussed later

Due Diligence: A How To Guide

- Hone your due diligence request list
  - Should be designed with the "cast a wide net" approach in mind
  - Use references to specific types of benefit plans to jog the seller's / target's memory
- What to ask for:
  - Plans, policies, agreements, arrangements, practices, including all amendments / restatements
    - Written and unwritten
  - Government communications – annual reports, determination letters, correction applications, audit materials
  - Participant communications – SPDs, SMMs, forms, notices

Due Diligence: A How To Guide (cont.)

- What to ask for: (cont.)
  - Funding arrangements – trusts, insurance policies, etc.
  - Compliance matters – litigation, prohibited transactions, etc.
  - Controlled group information – Title IV plans within the controlled group that might not be a part of the transaction
  - Terminated plans or plan previously withdrawn from
  - Vendor agreements
    - Costs
    - Indemnities

Due Diligence: A How To Guide (cont.)

- Engagement with seller / target benefits professionals
  - Use diligence materials to generate follow-up questions
  - Discussion of how benefit plans generally are operated at the seller / target
  - Conversations helpful to:
    - Understand current operations and participant expectations
    - Obtain information not readily available from documents

Transaction Structure: Acquisition of Entire Organization

- Stock Sales / Mergers
  - Mistaken belief that buyers / acquirers have little options other than negotiating representations and indemnity provisions
    - Certainly important and due diligence can have profound impact on deal terms
  - Use plan termination as a way to jettison unwanted plans prior to closing
    - 401(k) plans
    - Executive retirement plans
    - Other employee benefit plans (health and welfare, etc.)
  - Liabilities will transfer to buyer / acquirer

Transaction Structure: Acquisition of Entire Organization (cont.)

- Asset Sale
  - Buyer can pick and choose which plans, if any, to assume
    - Due diligence review should inform buyer of potential compliance risks with any assumed plans
  - Despite case law, many types of retirement plan liabilities not likely to transfer to a buyer of assets
  - Identify which plans may need to be recreated by buyer for transferred employees
    - Example – "mirror" 401(k) plan

Transaction Structure: Acquisition of Part of an Organization

- Stock Sale or Merger
  - Ability to terminate plans prior to closing
  - Can also require seller / target move plans to other parts of the organization to avoid automatic assumption
  - Moving plans generally requires board resolutions and plan amendments
  - Buyer / acquirer may still be responsible for pre-closing liabilities
  - Risk of claims against buyer / acquirer may be less if seller / target continues significant operations

Transaction Structure: Acquisition of Part of an Organization (cont.)

- Asset Sale
  - Same structuring options as a purchase of the entire organization
    - Pick and choose plans to assume / leave with seller
  - Can also move plans to other parts of the business that are not being sold

The Transaction Agreement

- Stock Sale / Merger
  - Equity provisions
    - Company retirement plans with company stock funds
    - Rabbi trusts
  - Employee benefits representations
    - Should be extensive to address plan document and operation issues
  - Covenants
    - Consider carve-outs from general prohibition on changes to address structuring considerations
    - Seller / target required actions to address compliance issues
  - Indemnities
    - Negotiated
    - Can be used to address identified compliance issues

The Transaction Agreement (cont.)

- Asset Sale
  - List assumed / excluded liabilities and acquired / excluded assets
  - Employee benefits representations
    - Generally more streamlined; however, consider successor liability potential
    - Also can be used to identify problems that can cause practical problems for acquirer (e.g., Code Section 409A)
  - Covenants
    - Consider carve-outs from general prohibition on changes to address structuring consideration
    - Seller / target required actions to address compliance issues
  - Indemnities are still important

The Transaction Agreement (cont.)

- Asset Sale (cont.)
  - ERISA Section 4204
    - Withdrawal does not occur as a result of an asset sale if:
      - Buyer obligated to contribute a similar amount
      - Buyer posts a bond for 5 years after transaction for average annual contribution amount
      - Purchase agreement provides seller is secondarily liable if buyer withdraws during 5 years after transaction
      - If the seller sells substantially all of its assets within 5 years after the transaction, the seller must post a bond

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- Mr. Cipolla is the leader in the firm's Richmond office of the employee benefit and executive compensation group. He assists a wide variety of clients including public, private, tax-exempt and governmental entities on qualified retirement plans, health and welfare plans, executive compensation and other related benefit matters.
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