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Successor Employer Liability Contagion Spreads

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Champagne and a steak dinner have traditionally marked celebrations at the close of a corporate deal. Celebrations these days are being marred by a party pooper—Employee Retirement Income Security Act (ERISA) pension plan successor liability. Increasingly, courts are delivering a "pay up now" notice to the buyer of financially challenged companies with underfunded pension plans through the use of innovative judicial remedies. On September 4, 2018, the Sixth Circuit Court of Appeals joined the Seventh and the Eighth Circuits in adopting a federal common law "categorical test" to impose withdrawal liability on a successor employer to a single employer pension plan.[1]

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The facts in *Findlay Industries* raised the court's collective eyebrows. As a consequence, the successorship rule initially adopted by the Seventh Circuit, in a case involving a predecessor company's multiemployer pension plan delinquent contributions, has now been extended to single employer pension plans.[2] Judge McKeague filed a very thoughtful separate concurrence and partial dissent which, unfortunately, will likely be ignored.

Findlay Industries was a family-owned business that produced auto parts until it went out of business in 2009. Long before the events giving rise to the lawsuit, it had created a pension plan to provide retirement benefits to its own employees. Providing pension plan benefits to one's own employees is deemed a "single employer pension plan" under ERISA 29 U.S.C. 1002(41). In 1986, Findlay transferred two pieces of real property to the company's founder and owner. He then transferred the real property to an irrevocable trust to provide for his two sisters. Upon the sisters' deaths, the trust property was to be distributed to the owner's two sons. From 1993 to 2009, the trust leased the property back to Findlay, thereby creating a revenue stream to support the two sisters.

In 2009, some 23 years later, Findlay folded. At the time Findlay went out of business, one of the founder's sons, Michael, was a 45-percent owner, the CEO, and a director. After Findlay ceased operations, Michael formed F(I) Asset Acquisition LLC. F(I) purchased the equipment, inventory, and receivables from two of Findlay's plants for $2.2 million in cash and $1.2 million in assumed debt. Those assets were eventually transferred to two companies owned and operated by Michael.[3] At the end of 2008, an outside company offered to purchase Findlay's assets on the condition that the potential purchaser be indemnified for any pension plan liabilities. Michael then made his own offer to purchase the assets, which did not assume the unfunded pension liabilities and did not ask for indemnification. Michael's offer clinched the sale.[4] Michael transferred the acquired assets to two companies he had recently formed. The two companies then hired substantially all of Findlay's employees, began producing the same auto products on Findlay's former premises, and continued selling auto parts to Findlay's largest customer.

According to the Pension Benefit Guaranty Corporation (PBGC), in 2009 when Findlay Industries folded, its pension plan was underfunded by $18 million. The initial purchase offer for Findlay's assets, unsurprisingly, did not offer to assume the pension liability. Between 2009 and December 2013, the net income generated by the two plants was $11.9 million. In 2013, the PBGC sued 10 different entities, claiming Findlay's $18 million liability had blossomed to $30 million when interest and penalties were added.

ERISA provides that employees of a "trade or business" that is under common control are treated as if they are employed by a single

employer. When a single employer pension plan is terminated, all trade or business in the controlled group are jointly and severally liable for the pension plans' underfunding liability. The same approach applies when an employer withdraws from a multiemployer pension plan. All members of the employer's controlled group are jointly and severally liable for the employer's withdrawal liability. Whether certain entities, such as trusts or investment funds, are considered to be "trades or businesses" and subject to controlled group liability is a complex issue subject to differing interpretations.

The PBGC sued Findlay, the Trust, Michael, and the two companies controlled by Michael for the pension plan's $30 million underfunding liability. The PBGC argued the Trust was a "trade or business" under common control with Findlay; they shared a "substantial economic nexus" because the Trust land was where Findlay operated. As such, the Trust was jointly and severally liable for Findlay's pension underfunding liability. The PBGC asserted that Michael and his two controlled companies were liable under the federal common law of successor liability because Michael had notice of the pension plan liabilities and then substantially continued Findlay's operations.

The district court agreed with Michael and dismissed the PBGC complaint. Recognizing that neither the Sixth Circuit court nor the Supreme Court has defined "trade or business" under ERISA, the district court started with the dictionary definition of each word.[5] The court explained that the dictionary "defines 'trade' as 'the business or work in which one engages regularly' and 'business' as 'a usually commercial or mercantile activity engaged in as a means of livelihood.'" The court held that the Supreme Court's *Groetzinger*'s test—that a person must regularly engage in the activity in question primarily for profit or income—embodies the "ordinary, common-sense meaning of the words at issue."[6] Because the trust was created "with the express purpose of providing for the care and eventual funeral expenses of [Gardner's] sisters," the court concluded that neither the plain meaning of the words nor the *Groetzinger* test supported a conclusion that the trust was a trade or business under ERISA.

In rejecting the PBGC's successorship liability theory, it ruled:

1. ERISA does not provide for successor liability for single employer pension plan underfunding,

2. The ERISA statute contains no "awkward gap" concerning single employer pension plans and corporate reorganizations (unlike multiemployer plans), and

3. Creating successor liability for single employer pension plans is not essential to carrying out the fundamental policies of ERISA.

The PBGC appealed, and the Sixth Circuit reversed. The Circuit Court of Appeals rejected the district court's use of the "trade or business" test in *Groetzinger*. They found the test in that Supreme Court case was limited to specific sections of the tax code. The Sixth Circuit then pointed to the ERISA policy holding employers and their commonly controlled business liable to employees for pension promises. To enforce these pension promises, the Sixth Circuit adopted the categorical test used by other circuits in the context of multiemployer pension plan disputes. According to the categorical test, any entity that leases property to a commonly controlled entity is a "trade or business" under ERISA. The benefit of the categorical test is that it prevents companies from fractionalizing their assets so as to avoid control group liability. For the Sixth Circuit, the Findlay family trust was a "trade or business" jointly and severally liable for Findlay's pension obligations to the PBGC.

The panel majority's opinion focuses on determining whether the trust could be held liable. Central to this discussion was the question of whether leasing real property constitutes a "trade or business." All three judges agreed that in the case's factual context, involving the Findlay plants situated on the Findlay family's land, the Findlay family trust was a trade or business and under common control.

The successor liability analysis, however, was more problematic. As experienced ERISA counsel are acutely aware, ERISA imposes an unfunded liability carryover for a variety of corporate reorganizations aimed at evading pension liabilities.[7] "Successor" liability was in an initial draft of this section of ERISA, but ultimately Congress decided not to include it. The panel majority, in a surprising moment of candor, acknowledged that because there had been a purchase of assets, "none of the provisions of Section 1369(b) apply."[8] No matter, the PBGC contended that the court could use its power to create federal common law to add the deleted successor liability language to the section anyway. The panel majority agreed over Judge McKeague's dissent.

In the panel majority's view, imposing successor liability served fundamental ERISA policies. They reasoned that advancing ERISA policies is one basis on which federal common law can be created. Allowing the PBGC to enforce an employer's promise of a pension to its employees furthered the purpose and structure of ERISA. The sale of Findlay's assets, and the eventual transfer to Michael's companies, frustrated the purpose of ERISA by attempting to allow Findlay to break its pension promises and throw off its liability for these pension promises onto the PBGC, while allowing Michael to use Findlay's assets to continue running the Findlay business and turn a profit. Allowing companies to break themselves up into different pieces so as to avoid their pension obligations injures plan participants and causes economic harm to the PBGC. It was not equitable:

> By giving the land to a commonly controlled entity, Findlay guaranteed that it still had the benefit of use (and likely control) of the land, just the same as if it had never given the land away at all. But now, the land did not technically belong to Findlay, so it did not count among Findlay's assets. Thus, Findlay had all of the meaningful benefits of the land, but none of the risk or responsibility that came with outright ownership. And the Gardner Trust did not have to put in any of the effort or face any of the risk of an arms-length leasing arrangement with a lessee that was not under common control. This situation is precisely the type that the common-control rules exist to prevent.[9]

As a result of the panel's reasoning, the decision by Congress when enacting ERISA to exclude successor liability for single employer pension plans was ignored. Instead, the omission of successor liability in the ERISA statute for single employer pensions provided the stepping stone for the Sixth Circuit to create the new federal common law of single employer pension plan successor liability.

A "familiar canon of statutory construction is that the starting point for interpreting a statute is the language of the statute itself. Absent a clearly expressed legislative intention to the contrary, that language must ordinarily be regarded as conclusive."[10]

The panel simply ignored the canons of statutory construction and concluded it could create federal common law to redress the inequities presented. The panel noted that two other courts (the Ninth Circuit and the Seventh Circuit) had used the categorical test to impose successor liability in the multiemployer pension context. The majority then adopted the categorical test and extended its reach to single employer pension plans. That said, the panel expressly limited its holding to these situations, in which the sale of the assets was "not conducted at arm's length."[11] It also directed the lower courts when considering successor liability to balance the interest of both parties to the litigation. It cautioned that a court should be "reluctant to impose successor liability when it might inhibit the reorganization of [a] failing business[]."[12]

Judge McKeague dissented. In his view, the legislative history of ERISA revealed Congress had already decided the successorship question. It was not up to the court to reexamine these policy choices of Congress and override them by creating federal common law. Judge McKeague cited a number of well worn and "ordinary" rules of statutory construction. Among them: if a statute speaks to an issue, a party cannot complain because "it does not like what the statute says" and where a statute allows for recovery on an issue "under some but not all circumstances," it is *not* silent.[13]

Turning to the legislative history of Section 1369(b), Judge McKeague noted that the labor committees of both houses of Congress had proposed that liability extend to a successor-in-interest. The Senate Finance Committee objected to that liability and proposed that successor liability not be included in the statute. The Senate Finance Committee carried the day (at least in Congress) and, as a consequence, successor language did not appear in Section 1369(b) when it was enacted.

Unlike the panel majority, Judge McKeague engaged in all three of the analytical steps the Sixth Circuit is supposed to use to determine if a court should exercise its power to create federal common law. The court should only create federal common law after evaluating "(1) whether ERISA is silent on the issue, (2) whether the statute leaves an awkward gap, or (3) whether common law is necessary to promote fundamental ERISA policies."[14]

Citing the Supreme Court's decision in *Hamdan v. Rumsfield*,[15] Judge McKeague concluded that when Congress had considered and rejected "the very language that would have achieved the result [a party] urges," the "silence inquiry" and the "awkward gap" questions were answered in the negative. In his view, the fact the Seventh Circuit and Ninth Circuit had composed successor liability in the context of multiemployer plans was a situation only Congress could fix. (Left unsaid was a second possibility—namely, that these two courts would reconsider their earlier opinions and reverse themselves and reject successor liability in the multi-employer plan context.)

Turning to the third and final basis for creating federal common law—the necessity of protecting a fundamental ERISA policy—he distinguished between creating federal common law and the creation of a new federal remedy. Judge McKeague concluded the fundamental policy analysis of the panel majority was flawed as it conflated ERISA's policy of ensuring payment to beneficiaries with providing the PBGC with a new remedy to recoup PBGC payments (the "real issue," as he characterized it in the lawsuit.)

The dissent suggested the solution to the PBGC's recoupment problem was better answered through the PBGC lobbying prowess. In his view, the legislative history suggested the narrow scope of Section 1369(b) was "at least somewhat intentional." If changes were to be made, it was up to the PBGC to lobby Congress and not the court. Judge McKeague concluded the court should eschew the role of a "superlegislature" and should not rewrite the law or alter a policy judgment that the court—but not Congress—deemed "unwise."[16] Thus, he would not impose successor liability.

Successor liability delivers a one-two punch to unsophisticated buyers. First, the buyer overpays for the assets it purchases, as it assumes the assets are unencumbered. It then has to pay the liability it assumed did

not exist. Numerous district courts are flocking to the successor liability bandwagon outside the Seventh and Ninth Circuits.[17] Buyers, once they recover from the shock, are in turn filing malpractice claims against their advisors. Attorneys or anyone else advising a purchaser of assets would be well served to investigate the possibility of pension plan successorship liability and, if unsure, to consult experienced ERISA counsel.

Buyers beware! Prior to buying a business with a pension plan it is necessary to engage an actuary to review the plan's funding status and history. Consider adding an escrow account to cover any potential pension liability or a broad indemnification clause to encompass successorship. Finally, a buyer should see if protective insurance is available.

NOTES

1. *Pension Ben. Guar. Corp. v. Findlay Indus., Inc.,* 902 F.3d 597 (6th Cir. 2018).

2. *See Upholsterers' Int'l Union Pension Fund v. Artistic Furniture of Pontiac*, 920 F.2d 1323, 1324 (7th Cir. 1990).

3. *Id.* at 602.

4. *Id.*

5. *Id.* at 603–604.

6. *Commissioner v. Groetzinger*, 480 U.S. 23, 24 (1987).

7. *See* 29 U.S.C. 1369(b).

8. *Findlay Industries, supra* n.1 at 610.

9. *Id.* at 607.

10. *Consumer Product Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S. 102, 108, 100 S.Ct. 2051, 2056, 64 L.Ed.2d 766 (1980).

11. *Findlay Industries*, *supra* n.1 at 612.

12. *Id.*

13. *Id.* at 619.

14. *Findlay Ind.*, *supra* n.1 at 618–619 (citing *DiGeronimo Aggregates, LLC v. Zemla*, 763 F.3d 506 (6th Cir. 2014)).

15. *Hamdan v. Rumsfield*, 548 U.S. 557 (2006).

16. *Findlay Industries*, *supra* n.1 at 621.

17. *See e.g., N.Y. State Teamsters Conference Pension & Ret. Fund v. C&S Wholesale Grocers*, No. 5:16-CV-84 (FJS/ATB), 2017 U.S. Dist. LEXIS 65505 (N.D.N.Y. May 1, 2017); *N.J. Bldg. Laborers' Statewide Pension Fund & Trs. Thereof v. CID Constr. Servs., LLC*, Civil Action No. 15-cv-3412 (SRC)(CLW), 2015 U.S. Dist. LEXIS 139628 (D.N.J. Oct. 14, 2015); *Reed v. EnviroTech Remediation Servs.*, 834 F. Supp. 2d 902, 910 (D. Minn. 2011); *Trs. of the Utah Carpenters' v. Daw, Inc.*, No. 2:07-CV-87 TC, 2009 U.S. Dist. LEXIS 892 (D. Utah Jan. 7, 2009).

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