Proskauer Benefits Brief: What Do You Mean I’m Liable? — Controlled Group Liability and ERISA Withdrawal Exposure

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Withdrawal liability can reach far beyond the withdrawing employer. The most common way a non-employer becomes liable is through controlled group liability.

In the first episode of this two-part series, senior counsel Neil Shah and partner Anthony Cacace explain how controlled group rules work, why they often catch businesses off guard, and how liability can extend across affiliated entities, and even to individual owners.

Neil Shah: Welcome to the Proskauer Benefits Brief: Legal Insight on Compensation & Benefits. I’m Neil Shah, a senior counsel at Proskauer. This is the third episode in our multi part series on withdrawal liability. Today, we’re talking about who other than the withdrawing employer actually owes the withdrawal liability. With us today is Anthony Cacace, a partner at Proskauer. Anthony, why don’t you tell us a little bit about what you do at Proskauer and how withdrawal liability comes up in your practice?

Anthony Cacace: Sure, Neil and, and thank you for having me and giving me the opportunity to participate in this episode. Withdrawal liability is a big part of, first, my practice personally here at Proskauer and the group's practice. I specifically spend most of my days counseling trustees of multi employer benefit plans. In particular, multi employer defined benefit plans, where withdrawal liability often comes up. Withdrawal liability comes up in many contexts, in our advice to trustees and plan sponsors of multi employer pension plans. But today, I think it's important we focus on the instances where an employer withdraws from a plan and is owed withdrawal liability, but that employer, as a legal entity, cannot satisfy its withdrawal liability obligation. When that happens, trustees and plan sponsors have an obligation to look beyond that withdrawn employer to other entities that may be liable for the withdrawal liability. And there are many ways in which trustees can pursue other entities to hold those additional entities responsible for the liability. So, from the plan perspective, it's important to examine which entities could be legally responsible to satisfy the liability, and in the context of employers who are withdrawing, it's not satisfactory or does not close the case that the withdrawn employer itself may not have the assets to satisfy liability because other related entities that could be connected to the employer may be responsible. So, we're going to examine today different theories of liability and those entities that may be liable beyond the signatory or withdrawn employer.

Neil Shah: Now, Anthony and I work together a lot on these types of matters, mostly on behalf of plans that seek to collect the withdrawal liability that's owed to them and sometimes on the side of the party from whom the plans are to collect these amounts. Anthony, what are some of the ways we've seen someone other than the withdrawing employer held liable for withdrawal liability?

Anthony Cacace: Sure, Neil. I think there's six ways, under federal law at least, that employers or related entities to employers can be held liable for withdrawal liability. There are other ancillary state law theories of liability that usually are used by plan sponsors when a judgment has already been secured. But prior to a judgment being secured, there is six ways that plans and trustees can hold entities liable for withdrawal liability. The most common way that entities are responsible for withdrawal liability is if entities are determined to be under common control with the withdrawn employer. And in order for that to apply, they have to be a trade or business under common control. And this is generally known as control group liability. Neil, do you have any thoughts on the considerations going into determining whether an entity is related such that it could be construed within the control group of a withdrawn employer?

Neil Shah: So, most courts that consider this issue use a test established by the Supreme Court in the 1980s in a tax case. And they ask whether the activity that is being conducted is to earn income on a continuous basis. So, for example, a, a one off yard sale is probably not a trade or business. A yard sale held every month for a few years, well, that's probably a closer case. The point is continuity and some type of a profit motive. In practice, what this means is that if you are a C corporation, an LLC, an LLP — some type of registered business organization with a particular tax status — it's going to be really hard to argue that you're not a traded business. On the other hand, this issue does still come up in kind of unique circumstances and we'll have a whole episode where that comes up in the context of private investment funds. The other area where this usually is heavily litigated is where someone is running an unincorporated business. Think of, like I mentioned before, a yard sale, some type of a side hustle, more commonly a property rental of real estate that's owned in the name of the owner of a company. There's a lot of litigation over these types of issues and we'll have a whole episode on that coming up as well.

Anthony Cacace: I think that covers the first element, Neil, but what about common control? What are the ways that a third party related entity could be determined to be under common control such that they could face liability?

Neil Shah: So on, on that issue, the statute itself borrows from the tax code. There're generally three types of ways to establish common control. The first is parent subsidiary, which is where a parent owns at least 80% of a subsidiary, either directly or indirectly. The second type is a brother sister controlled group and that's where the same person or persons own at least 80% of two distinct companies. And then, the third is, is just a combination of those two. So, you might have a multifaceted organization that has a number of parents, it might have brother sister companies as part of that and you can kind of aggregate all of those theories into one.

Anthony Cacace: In those examples, who would be liable?

Neil Shah: So, it is the entire controlled group that's liable. So, let's just say, for the example, the subsidiary company withdraws. That's the one that had signed the collective bargaining agreement, agreeing to contribute to the multi employer pension plan, and that's the one whose obligation to contribute ended and constituted a, a withdrawal. Its parent company is part of its control group. That means its parent company is liable. If it has a brother sister relationship, meaning that its parent company also has some other subsidiary, that other subsidiary, its sister company, is also liable. So, the answer is that the entire control group becomes liable.

Anthony Cacace: And they're liable jointly and severally, meaning that each member of that control group is liable for the full amount if another member of the control group cannot pay?

Neil Shah: That’s correct. And so, if there’s issues on apportioning liability among the members of the control group, that’s their business, but from the plan’s perspective, they’re entitled to go after whomever in the control group that they want. So, here’s where this becomes a little bit more interesting: controlled group rules can reach the owner of a company personally. So, many small and mid sized businesses have one person who owns the company and the real estate itself. And if that person rents out the property, that rental activity can, can be deemed a sole proprietorship and, under a developed body of case law, can be treated as a trade or business that’s under common control. What this means then is that the owner of the company becomes personally liable. So, for instance, some businesses avoid personal liability here is they’ll have the real property owned by a separate company, such as a single member LLC. So that will avoid personal exposure, but then that LLC will still be liable as a member of the control group.

Anthony Cacace: So, there’s a scenario then where if an individual owns a parcel of real property, and that same individual also owns a company who has an obligation to contribute to a defined benefit pension plan, and ultimately that company withdraws, if that individual who owns that parcel of property was using that parcel of property for rental income, the owner of that property can be personally liable for the company’s withdrawal liability?

Neil Shah: Yes, exactly. So, like I said, this is not something that I think anyone who would set up the company this way and the real property this way, they’re not going to expect this. And, and this is sometimes a hard conversation that attorneys have to have, whether they are representing the owner of the company or they’re on the other side and are representing the plan and they have to tell the other side why they are liable.

Anthony Cacace: Switching gears, how does this common control test apply to private investment funds?

Neil Shah: So, where an employer is a portfolio company of a private investment fund, you might have a situation where the plan wants to go after not just the portfolio company, but other companies that are part of the portfolio, or they might want to go after the entire private investment fund itself, its manager or other sister funds. The reason being that the portfolio company might have failed and gone out of business and is unable to satisfy the liability. The issue that we have in these types of cases — not so much whether there's common control, just because those rules are fairly technical — the issue that comes up in these cases are is each of those other entities that they want to go after, are they in fact a trade or business or not? The inquiry is very fact intensive. It's been a, a kind of a developing area of law within the last few years. And rather than go through it at all here, we're going to devote a separate episode to discuss just that topic. One additional control group wrinkle that also catches some people off guard is the control group rules have attribution rules. So, what that means is that just because a company is owned by individual A does not mean that person's ownership cannot be attributed to individual B. Usually this comes into play when you're dealing with ownership that's spread across a family. So, for example, if a husband owns the employer that contributes to the plan and a wife owns the real estate entity, their interests can be attributed to each other, potentially putting both within the same control group.

Anthony Cacace: So essentially, putting assets in the name of a spouse is not a foolproof way to insulate yourself if you're a contributing employer from potential withdrawal liability exposure.

Neil Shah: So, for instance, if you're in a community property jurisdiction, the interests that one spouse owns are also owned by the other. But in most jurisdictions, that's not the case. Spouses have separate ownership interests and property. The control group roles look beyond that. Attributing ownership between spouses is probably one of the most common ways that ownership interests are attributed to each other and it catches many people by surprise.

Anthony Cacace: Understood. So, moral of the story here is from the plan's perspective, control group liability, probably the most effective way to hold entities beyond the signatory employer responsible for withdrawal liability, from the employer's perspective, it's really incumbent upon the employer to analyze its own control group to make determinations as to which entities may ultimately be responsible for withdrawal liability to a plan in the event a member of a control group does affect a withdrawal from a plan that has withdrawal liability exposure. Is that right?

Neil Shah: Yes, that's, that's exactly the case. It's just not necessarily intuitive. And because there are specific rules that apply here, it's important that if you are a plan, a trustee, that you represent an employer, that you just know that this is out there.

Anthony Cacace: So, thanks for that analysis, Neil, on the control group liability. That was the first way where an entity beyond the contributing employer could be held liable for withdrawal liability. And on a next episode, Neil, why don't you preview the other five ways in which an entity beyond the contributing employer could be held liable for withdrawal liability outside of the common control theory?

Neil Shah: So on the next episode, we'll cover single employer liability. We'll cover alter ego liability. There's successor liability. And then there's two more. One is to combine all of the above. And then the last way is what's known as evade or avoid transactions, which come in a couple of different flavors. We'll cover all of that in our next episode. If you found this useful, be sure to follow us and subscribe on Apple Podcasts, Spotify and YouTube so you don't miss the next episode. If you liked what you heard or want to know more, drop us a line at wl@proskauer.com. Today's discussion is for general information and is not legal advice. Thanks for listening to the Proskauer Benefits Brief.

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