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Liquidation Lessons From 11th Circ. Pension Plan Ruling

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In *Pension Benefit Guaranty Corp. v. 50509 Marine LLC et al.*[1] the U.S. Court of Appeals for the Eleventh Circuit held that the Pension Benefit Guaranty Corp. can recover an employer's defined benefit pension plan termination liability—often millions of dollars—from controlled group members that did not even exist when the contributing employer liquidated years earlier.[2]

This decision, issued on Nov. 24, 2020, is important for business owners, including private equity funds, holding companies and conglomerates, because if a liquidating employer's defined benefit plan is not properly terminated, the employer's future controlled group members may be on the hook for its termination liability.

This article will discuss what the court referred to as the "confluence of bankruptcy, employee benefits, and corporations law" that arose in this case, and how to avoid a similar outcome.[3]

Background

In the 1980s, Liberty Lighting Co. was a unionized company contributing to a defined benefit pension plan[4] and was also the plan sponsor.[5] In the early 1990s, after experiencing financial difficulties, the employer commenced bankruptcy, terminated its employees, liquidated and was administratively dissolved under Illinois state law.

Under federal law, a business that liquidates under Chapter 7 of the Bankruptcy Code does not receive a discharge of its debts, and the Employee Retirement Income Security Act provides the sole means for a debtor to terminate a defined benefit pension plan.[6] Critically, the PBGC asserted that it was not notified in 1992 of the plan sponsor's bankruptcy or liquidation.[7]

Liberty's sole owner, Joseph Wortley, filed his own personal Chapter 7 bankruptcy and received a discharge of his debts.[8] As part of Wortley's bankruptcy, his assets, including his stock in Liberty, were surrendered to a trustee.

Significantly, even after Liberty liquidated in bankruptcy, sufficient assets remained in the plan to permit Liberty to continue making pension payments to the plan. At the request of the plan's actuary, Wortley signed documents on behalf of the plan as the plan's administrator[9] for several years after Liberty's dissolution. Wortley was told by an actuary and bank that this procedure was necessary to ensure continuing payments to pensioners.

In 2012, 20 years after Liberty had liquidated under bankruptcy and dissolved under state law, the plan's funds ran low. The bank administering the plan notified the PBGC of the plan's looming insolvency. The PBGC asserted that it never received notice of Liberty's bankruptcy until it was approached by the bank.

In an effort to avoid the expense and delay of litigation, the PBGC approached Wortley about terminating the plan without filing a lawsuit to establish plan termination.[10]

Ultimately, the parties settled, agreeing there was $6.2 million in plan liability—the settlement referred to as the trusteeship agreement. The signatories to the trusteeship agreement were the PBGC and the plan administrator.[11] Among other things, the trusteeship agreement provided that while Liberty had dissolved under state law in 1992, the plan terminated on July 31, 2012, 10 years later.

The PBGC Sues the Owner's Other Companies Claiming Controlled-Group Liability

In 2018, six years after entering into the trusteeship agreement, the PBGC sued Wortley and 19 companies in which he had an ownership interest—the controlled group—on July 31, 2012, the date of the plan's termination.[12]

The PBGC did not sue Liberty, a long-dissolved entity with no assets.[13] The PBGC alleged that Wortley and the controlled group were jointly and severally liable for Liberty's unpaid termination liability because they shared common ownership with Liberty.[14] The PBGC's theory was if Liberty could not pay the remaining amounts owed to the plan, then Wortley and the controlled group members, which were not parties to the trusteeship agreement, should pay.[15]

Wortley and the controlled group argued that (1) Liberty could not be responsible for the plan in 2012 because of its earlier bankruptcy liquidation and state law dissolution, (2) Wortley could not be responsible because of his personal bankruptcy, and (3) the PBGC was not responsible because it never took control of the plan. Effectively, Wortley asserted that no one was responsible for the liability.

On Nov. 22, 2019, in what the U.S. District Court for the Southern District of Florida called a difficult case, it granted summary judgment to the PBGC, effectively holding that Liberty's dissolution under state law 20 years earlier did not terminate its status as the plan's contributing sponsor under ERISA.[16]

The Eleventh Circuit's Decision

The question presented to the Eleventh Circuit on appeal was whether Liberty, the employer, was the contributing sponsor to the plan under ERISA on July 31, 2012, when the plan terminated.

The Eleventh Circuit began its analysis by noting that, under Illinois law, a company could sue or be sued for five years after its dissolution. The parties disagreed whether this five-year period affected a company's liability as a contributing sponsor under ERISA.

The controlled group argued that a company ceases to exist for all purposes after the five-year period, including under ERISA. The PBGC argued that a company's dissolution has no effect on an entity's federally defined role as a contributing sponsor. The Eleventh Circuit agreed with the PBGC, holding that the five-year period pertained solely to whether the dissolved company could be sued or not, meaning an employer may continue to be a contributing sponsor under ERISA even after its state law dissolution.

The Eleventh Circuit found that neither ERISA nor Illinois law resolved what to do with pension liabilities when a plan sponsor dissolves but the plan continues to operate. Where ERISA was silent, the court held that it was required to develop new federal common law to achieve ERISA's central goal of protecting pension beneficiaries.

After considering several acts taken by the plan sponsor, Liberty, the court held that it continued to serve as the plan's de facto sponsor after its dissolution.

Therefore, the Eleventh Circuit held

> that where the sponsor of an ERISA plan dissolves under state law but continues to authorize payments to beneficiaries and is not supplanted as the plan's sponsor by another entity, it remains the constructive sponsor such that other members of its controlled group may be held liable for the plan's termination liabilities. Thus, the Controlled Group members are liable to the PBGC for the Plan's termination liabilities because the Employer persisted as the Plan's sponsor even though it dissolved as an Illinois corporation.[17]

Takeaways

When Liberty was liquidated, Wortley, the owner, likely assumed that the business's liabilities were left behind once the bankruptcy case closed. As demonstrated by this case, this was not true.

Unfortunately, there is no blueprint for ensuring any potential future liabilities are eliminated during a bankruptcy case because each case is fact-specific.

Below is a non-exhaustive list of issues, however, that the owner should have considered during the bankruptcy case. Business owners should be aware of these when liquidating a business that contributes to a defined benefit pension plan.

- Plan termination is a separate event from filing for bankruptcy. A defined benefit pension plan may only be terminated pursuant to the procedures set forth in ERISA.[18] Thus, a Chapter 7 trustee or debtor in possession cannot reject a defined benefit plan under Section 365 of the Bankruptcy Code and may only terminate the plan pursuant to ERISA's procedures.[19]
- The employer was required to notify the PBGC of its liquidation. In this case, we do not know if that occurred during the bankruptcy case, however, the plan administrator's actions to maintain the plan after the employer liquidated were plainly evidence the court considered when making its decision. Best practice is to terminate a defined benefit plan while in bankruptcy as ERISA provides that the date of the filing of the bankruptcy petition is treated as the plan's termination date.[20] This is applicable in liquidations and in Chapter 11 reorganization cases when a debtor terminates its defined benefit pension plan.
- Upon termination of its plan, the employer should have transferred the remaining plan assets to an unaffiliated plan sponsor or to the PBGC. If the plan assets had gone to the PBGC during the employer's bankruptcy, then the case would have been over.
- When the employer liquidated under the Bankruptcy Code it did not receive a discharge of its debts. The same is true for any company that liquidates under the Bankruptcy Code; their debts are not discharged.
- When the plan administrator settled its defined benefit pension plan termination liability with the PBGC, it should have endeavored to include all the owner's then-existing companies as third-party beneficiaries to the settlement or sought releases for each of them given that they did not exist when the employer liquidated under state law.

Business owners who do not consider these issues may be haunted for decades by companies that liquidated long ago.

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[1] Pension Ben. Guar. Corp. v. 50509 Marine LLC , et al., 981 F.3d 927, 2020 U.S. App. LEXIS 37026 (11th Cir. 2020).

[2] Generally speaking, companies are considered to be members of the same "controlled group" if there is at least 80% direct or indirect common ownership between or among them. Under ERISA, members of a controlled group are jointly and severally liable for certain obligations, including single-employer-pension liabilities, plan-termination premiums, failure to notify the PBGC of reportable events (e.g., bankruptcy), and withdrawal liability.

[3] Pension Ben. Guar. Corp., 2020 U.S. App. LEXIS 3702, *2.

[4] A "defined benefit plan" is a pension plan that promises participants a specified benefit, usually a monthly amount, at retirement. Typically, the benefit is based on some combination of the participant's years of credited service, salary, and age. PBGC insures most defined benefit plans sponsored by private (non-governmental) employers. See https://www.pbgc.gov/glossary (last visited January 5, 2021).

[5] A "Plan Sponsor (Single-Employer Plan)" is an employer that establishes or maintains a pension plan for its employees. See https://www.pbgc.gov/glossary (last visited January 5, 2021).

[6] 11 U.S.C. §727(a); ERSIA §4041(a)(1).

[7] The PBGC is a wholly-owned government corporation established under ERISA in the Department of Labor. ERISA §4002. The PBGC is charged with protecting the retirement incomes of workers in private-sector defined benefit pension plans. ERISA requires companies that maintain pensions to notify the PBGC if a pension plan is at risk for termination, because it administers pension plans for companies that have ceased to do business. A pension plan is at risk for termination if the company administering the plan enters bankruptcy or dissolves. Given that the Employer's initial bankruptcy case had occurred in 1992, however, prior to the electronic recordation of bankruptcy case dockets, the paper file of the Employer's bankruptcy case has been discarded by the U.S. bankruptcy court. Therefore, there was no record of whether the Employer had notified the PBGC during its bankruptcy case.

[8] Unlike businesses, individuals are eligible to receive a discharge of many of their debts in a chapter 7 bankruptcy case, subject to the objection of parties in interest with standing to object.

[9] A "Plan Administrator" is the person or entity responsible for running the pension plan. Typically, the plan administrator is identified in the plan document. If the document does not name an administrator, the plan sponsor is the administrator. See https://www.pbgc.gov/glossary (last visited January 5, 2021).

[10] Under ERISA, single-employer pension plans may be terminated "voluntarily" by the plan administrator, or "involuntarily" by the PBGC. Voluntary terminations are initiated by the plan administrator and are either "standard terminations" or "distress terminations." ERISA §4101(b) and (c). In either case, 60 days before the proposed termination date, the employer must give to each "affected party" (including, among others, each plan participant or beneficiary and the PBGC) a notice of its intent to terminate the plan. ERISA §4041(a)(2). Involuntary terminations are initiated by the PBGC. ERISA §4042. If the PBGC commences an involuntary termination, it must institute proceedings to terminate the plan, including applying to the appropriate district court for an order appointing a trustee to administer the plan. Id. The date of plan termination is determined by the court or by agreement of the parties. ERISA §4048(a)(3)-(4).

[11] The Owner signed the Trusteeship Agreement as Plan Administrator and the Employer's "Putative President." The Owner was not party to the Trusteeship Agreement in his individual capacity.

[12] Pension Ben. Guar. Corp. v. 20 Se. 3rd St LLC, 424 F. Supp. 3d 1239, 1244 n.1 (S.D. Fla. 2019).

[13] Under the Bankruptcy Code, unless the court orders otherwise, any property properly scheduled (i.e., listed) by the debtor in its bankruptcy petition that the bankruptcy trustee does not administer (e.g., use or sell) at the time of the closing of the debtor's case is "abandoned to the debtor." 11 U.S.C. §554. Accordingly, the Employer's stock was returned to the Owner upon the conclusion of the Owner's bankruptcy. The return of the Employer's stock provided the Owner with the authority to act on the Employer's behalf with respect to the Plan. See Pension Ben. Guar. Corp., 424 F. Supp. 3d at 1242.

[14] It is unclear from the record whether the PBGC was aware of the Owner's other companies at the time it entered into the Trusteeship Agreement.

[15] Generally, individual shareholders and officers are not liable for unpaid contributions to pension plans in the absence of alter ego allegations or evidence that such an individual has defrauded or engaged in conspiracy to defraud the plan. Where a partnership is a member of a controlled group, however, the general partners may, under applicable state law, be liable for the partnership's ERISA obligations. P. Clapp, Bankruptcy Litigation Manual, 19-47, Ed. M. Cook (2020). Note that the sole shareholder of a group of affiliated companies may also be personally liable for the pension obligations of a bankrupt member of the group. Id. (citation omitted).

[16] The district court held that "only □ for the purposes of a federal, ERISA-focused application of ERISA defined terms (such as a contributing sponsor), a state-law based dissolution does not disturb an entity's federal, ERISA contributing-sponsor designation. To hold otherwise would permit contributing sponsors to circumvent the requirements of ERISA. ERISA provides for the orderly termination of a contributing sponsor's liability, but if state law dissolution also terminated a sponsor's ERISA liability an entity could dissolve, not notify Plaintiff of the dissolution, and thereby avoid all ERISA-based liability. That is exactly what is alleged to have happened in this case." Pension Ben. Guar. Corp., 424 F. Supp. 3d at 1246.

[17] Pension Ben. Guar. Corp., 2020 U.S. App. LEXIS 3702, *11.

[18] ERSIA §4041(a)(1).

[19] Bankruptcy Litigation Manual, at 19-13.

[20] ERISA §4022(g).

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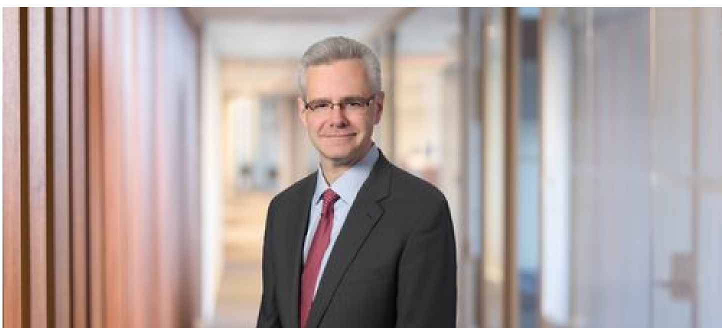

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