Getting BLOOD From a When Contributing Em Are Insolvent

The authors suggest practical strategies for collecting contributions from employers that are insolvent or approaching insolvency. A second part, in the December *Benefits Magazine,* offers collection strategies in cases where employers seek bankruptcy protection.

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It is no secret that multiemployer pension funds are facing a multitude of threats, many of which are beyond the control of plan administrators. Over the past decade, many multiemployer pension plans suffered dramatic underfunding caused by investment losses and business failures of contributing employers. This underfunding has been compounded by the growing disconnect between the number of retirees and the decreasing base of active participants. Bankruptcy filings by contributing employers have also impacted the economic stability of multiemployer plans.

While plan administrators are defenseless in the face of a global economic meltdown and shifting demographics, the one area where they can influence the pension fund's bottom line is in the recovery of unsatisfied obligations owed by contributing employers.

Faced with a contributing employer in financial duress, pension funds have explored novel legal strategies to recover delinquent contributions and/or withdrawal liability from employers and collateral sources. Obtaining a judgment against a contributing employer often is just the tip of the iceberg. Many contributing employers default on their pension obligations because they are insolvent or approaching insolvency.

In such instances, multiemployer plans must develop a comprehensive strategy to explore all potential avenues of recovery. Any insolvency strategy must contemplate a complete examination of ERISA-based remedies against third parties that may be obligated to satisfy the insolvent contributing employer's obligations.

Pension funds must also be prepared to address the various risks and opportunities that will undoubtedly arise if the employer files for bankruptcy protection—the topic of the second part of this article, which will be in the December *Benefits Magazine*.

Insolvent Contributing Employers

Frequently, contributing employers will respond to a demand for unpaid pension obligations by turning out their pockets and asserting the "we're broke" defense. More often than not, these employers expect pension funds to take them at their word and agree not to explore whether the cries of insolvency are legitimate.

When evaluating allegations of insolvency, the first-layer analysis begins with a forensic accounting examination into whether the employer is truly judgment-proof. A thorough investigation often will entail a review of financial records, including audited financial statements, income statements and balance sheets to determine whether the contributing employer has any free cash flow or other unencumbered assets with which to satisfy the obligations. An understanding of the contributing employer's cash flow, sales data and tax records will also provide useful information regarding its financial viability.

Pension funds should have an understanding of the contributing employer's industry and other macro- and microeconomic factors in order to conduct a global assessment of the long-term financial prospects for the company. Identifying how the company is paid may also lead to potential sources for recovery. In the event the fund recovers a judgment against the contributing employer, customers of the contributing employer may prove to be fruitful grounds for targeted garnishment proceedings.

Financial records will also highlight any transfers of assets that were made by the contributing employer to affiliated entities or insiders. The pension fund may be able to recover the value of transfers that were made to avoid or evade withdrawal liability or that can be characterized as fraudulent transfers.

When conducting this asset analysis, two factors should be kept in mind. First, if the documents that are being reviewed have not been audited, they may not provide an accurate picture of the contributing employer's finances. Second, it may be useful for a professional to conduct forensic analysis of the documents to discover potential assets and/or avoidable transfers that may not be readily apparent to the untrained eye.

Obtaining Financial Information

ERISA

ERISA arms multiemployer plans with a mechanism to secure information and documents from contributing employers before litigation is commenced. Specifically, 29 U.S.C. §1399(a) requires an employer to furnish information and documents relating to, among other things, corporate organization and information, cessation of business operations, affiliated trades or businesses, tax records and assets sales.[1]

Discovery in Litigation

If litigation is commenced, the Federal Rules of Civil Procedure, which govern litigation in federal courts, authorize extensive discovery into any matter reasonably calculated to lead to the discovery of admissible evidence.[2] Accordingly, the pension fund can obtain information and documents through traditional civil discovery methods, such as interrogatories, document requests and deposition testimony. Importantly, the Rules of Civil Procedure also allow litigants to subpoena testimony and documents from nonparties.

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Travis J. Ketterman. International Foundation. 2009.

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Satisfying Judgments Against Contributing Employers

Discovery in Aid of Execution

In the event the pension fund is successful in obtaining a money judgment against the contributing employer, the Federal Rules of Civil Procedure provide for a wide range of discovery to assist the plaintiff in discovering assets that could be liquidated to satisfy the judgment. By using these post-judgment procedures, the pension fund can serve document requests and interrogatories and obtain deposition testimony. These will assist the pension fund in, among other things, locating any assets, identifying any potentially avoidable transfers, identifying third-party sources of recovery and investigating the insolvency of the contributing employer. The financial records also provide a mechanism that will force the contributing employer to comply with discovery requests if it does not readily do so.

Execution Strategies

Once the assets are identified, the Federal Rules of Civil Procedure provide a mechanism to liquidate those assets to satisfy the money judgment. For example, if the contributing employer owns real estate that is not fully encumbered by liens and/or other interests, a judgment creditor could commence proceedings to compel the United States Marshal to auction the real estate to the highest bidder. At the conclusion of the sale, the pension fund would receive either a deed for the property (subject to any liens, claims or encumbrances that are superior to the pension fund's judgment) or the net proceeds of the sale of the property to a third-party bidder. As mentioned, execution strategies may also entail, among other things, selling other assets of the contributing employer or identifying the contributing employer's accounts receivable and garnishing any funds owed to the employer that are being held by its customers or others.

Other Avenues for Recovery

If direct recovery against the contributing employer is not possible, another possible step to satisfy the judgment is to explore potential third-party sources of recovery. Where the employer itself is judgment-proof, a full investigation into whether any of the following strategies could provide a collateral source of recovery would be warranted. It is important to note that these strategies are not mutually exclusive and may be pursued in a coordinated effort to satisfy the outstanding obligations.[3]

Controlled Group Liability

The first avenue most pension funds explore is controlled group liability. Under Section 4001(b) of ERISA, liability for unpaid pension obligations extends to trades or businesses that are under *common control* with a contributing employer. In other words, the contributing employer and any affiliated trades or businesses are treated as the same entity. Entities under common control may be held jointly and severally liable for the contributing employer's obligations.[4] This holds true regardless of whether the affiliated entities are participants in the pension fund. There are several different forms of controlled groups, the most common of which are *parent-subsidiary* (business entities share a common parent) and *brother-sister control group* (two entities share a common ownership).

It is important to note that when a contributing employer is a smaller enterprise, a "trade or business" operated by a principal of the contributing employer may fall under common control.[5] Courts will examine whether the principal's enterprise is a trade or business or simply a passive investment, the latter of which does not form the basis for imputing withdrawal liability. To qualify as a trade or business, the economic activity must be performed for the primary purpose of income or profit and with continuity and regularity.[6]

Successor Liability

Another potential avenue of recovery is successor liability. Under ERISA, an entity that purchases the assets of a contributing employer may be held liable for unpaid pension obligations in its capacity as successor to the plan participant. While the general common law rule provides that an asset purchaser does not assume the seller's liabilities except in limited circumstances, federal courts have developed a federal successor liability doctrine providing that an asset purchaser may be liable for the seller's delinquent contributions and withdrawal liability.[7] To impose such liability, courts will examine, among other things, whether the buyer had notice of the outstanding obligations and the purchaser continued the operations of the seller. In examining the second factor, courts will consider the continuity of the seller's workforce, management and equipment; completion of work orders commenced by the seller; and continuity of customers.

Private Equity Funds

Another example of the evolving collection strategies used by pension funds was at the heart of a decision from the U.S. Court of Appeals for the First Circuit in *Sun Capital Partners III, LP, et al. v. New England Teamsters & Trucking Industry Pension Fund*.[8] The target in *Sun Capital* was a private equity fund that had acquired all of the ownership interests in a struggling metal producer. The acquisition was a classic turnaround transaction made with the purpose of improving the company's bottom line through the implementation of a restructuring plan and introduction of new management. In a decision that is already sending shock waves throughout the private equity community, the First Circuit held that the private equity fund may be held liable for the withdrawal liability the metal company owed to the pension fund.

Avoidance of Transactions and/or Transfers of Assets

During its investigation, a pension fund might learn that the contributing employer transferred assets to a shareholder or related entity while it was insolvent or approaching insolvency. Such transfers often are made to shield unencumbered assets from the reach of creditors, including pension funds. In such instances, a pension fund has a number of weapons at its disposal under ERISA as well as under common law to avoid and recover such assets for the benefit of the pension fund. In an action to recover such assets, a number of legal theories may be pursued to unwind the transaction. Further, it is possible that a number of these theories could be asserted in a complaint either in the alternative or as complementary proceedings.[9]

- *Constructive trust:* Although the incorporation of a business entity typically will shield the individual owners from the company's liability, constructive trust principles have been applied to reach assets transferred to shareholders. Typical examples of constructive trust applications are found where a closely held corporation transfers assets to a shareholder prior to dissolution, leaving the employer insolvent. In such instances, courts will exercise their equitable powers under ERISA and impose a constructive trust on any assets transferred for the benefit of the pension fund.[10] Notably, courts may impose a constructive trust on any transferred assets without running afoul of well-recognized state laws that prohibit the imposition of personal liability on shareholders for the debts of the corporation. The corporate form remains protected because, under constructive trust principles, "recovery is limited to those assets transferred to the shareholder before the corporation's debts have been satisfied."[11]
- *Fraudulent transfer:* Asset transfers should also be scrutinized to determine whether they can be avoided and recovered as fraudulent transfers. Most states have fraudulent transfer laws based on the Uniform Fraudulent Transfer Act that enables creditors to avoid and recover transfers that are made with the actual intent to hinder, delay or defraud creditors or under circumstances found to be constructively fraudulent.[12] Thus, where the contributing employer makes a fraudulent transfer, especially to an affiliated entity or shareholder, such transfer may be avoided for the benefit of the pension fund.
- *Unwinding transactions to avoid or evade pension liability.* Under 29 U.S.C. §1392, if the principal purpose of any transaction is to evade or avoid liability to a pension fund, the "liability may be determined and collected without regard to such transaction." The "avoid-or-evade" provisions of ERISA are intended to discourage companies from "using corporate forms and manipulations to shield themselves from withdrawal liability."[13] In other words, liability is determined as if the transaction to avoid or evade liability never occurred, and the pension fund can reach the assets from the parties to whom the assets were improperly transferred.

As a practical and strategic matter, it may be easier for the pension fund to prove the elements of an ERISA avoid-or-evade cause of action than it is to satisfy the elements of a fraudulent transfer or constructive trust. Different statutes of limitation for the various causes of action may also factor into the analysis of which remedies to pursue.

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- Pension funds should not accept a contributing employer's word that it is insolvent; the fund needs to investigate whether the employer has any free cash flow or unencumbered assets.
- Funds may want to hire a professional to conduct forensic analysis of employer documents to discover potential assets and/or asset transfers that may not be readily apparent.
- An employer must furnish documents related to corporate reorganization and information, cessation of business operations, affiliated trades or businesses, tax records and assets sales.
- A fund may want to explore, possibly using multiple strategies, potential third-party sources of recovery such as entities under common control if the fund can't recover directly from an employer.
- An employer may transfer assets to a shareholder or other entity to shield them from the reach of creditors. ERISA and common law give a pension fund several tools for recovering those assets.

Endnotes

1. 29 U.S.C. 1399(a) provides that "An employer shall, within 30 days after a written request from the plan sponsor, furnish such information as the plan sponsor reasonably determines to be necessary to enable the plan sponsor to comply with the requirements of this part."

2. Fed. R.Civ.P. 26(b)(1).

3. Plan administrators should also be mindful of the fact that insolvency is not always a static concept. A company that is insolvent today may experience a turnaround and be in a position to satisfy the judgment in the future.

4. The underlying purpose of this provision is to prevent businesses from shirking their ERISA obligations by fractionalizing operations into separate entities. *Central States, Southeast and Southwest Areas Pension Fund v. White*, 258 F.3d 636, 644 (7th Cir. 2001). In other words, a contributing employer cannot shield itself from pension obligations by maintaining all of its assets in one entity and assuming pension obligations through a related shell company.

5. An example of the application of the "trade or business" theory can be found in *Central States, Southeast and Southwest Areas Pension Fund v. Messina Products, LLC,* 706 F.3d 874 (7th Cir. 2013), where the court found that a husband and wife who were the principals of a contributing employer could be held personally liable for the employer's withdrawal liability. The principals also owned commercial and residential real estate and leased the commercial property to the contributing employer. After the contributing employer withdrew from the pension fund, the fund filed an action against the employer, and the husband and wife, to recover withdrawal liability. The fund asserted that the husband and wife were under common control with the contributing employer on the grounds that the real estate was a "trade or business." The Seventh Circuit concluded that the rental activities of the principals were a "trade or business" under common control with the contributing employer and the individuals could therefore be held liable for the employer's withdrawal liability. Id. at 884.

6. Id. at 878.

7. Beginning with the United States Court of Appeals for the Seventh Circuit's opinion in *Upholsterers' Intern. Union Pension Fund v. Artistic Furniture of Pontiac,* 920 F.2d 1323, 1325 (7th Cir. 1990), several federal appellate and trial courts have expanded the doctrine of successor liability to enable pension funds to recover delinquent contributions from an asset purchaser.

8. *Sun Capital Partners III, LP, et al. v. New England Teamsters & Trucking Industry Pension Fund,* No. 12-2312 (1st Cir. July 24, 2013).

9. Under Federal Rules of Civil Procedure 8(d)(2), a party may set out two or more statements of a claim alternatively. When formulating their complaints, pension funds should also assess whether any such claims are preempted under ERISA. See, generally, *Central States, Southeast and Southwest Areas Pension Fund v. Denny,* 250 F. Supp. 2d 948 (N.D.Ill. 2003)(discussing ERISA preemption of fraudulent transfer claims). Alter ego and piercing the corporate veil clams may also be worth exploring; however, preemption or legal viability may preclude or limit the assertion of such claims as well.

10. Funds should also review the respective trust agreement to determine whether an argument can be made that any monies held by the employer are being held in trust for the fund.

11. *Central States, Southeast and Southwest Areas Pension Fund v. Minneapolis Van & Warehouse Co.,* 764 F. Supp, 1289, 1294-95 (N.D.Ill. 1991) (quotations omitted). In *Minneapolis Van,* the contributing employer transferred certain real estate and other assets to its owner four days before the company dissolved. The transfer left the company insolvent. The day after the asset transfer, the pension fund assessed the employer with withdrawal liability and thereafter filed an action against the employer and the principal. Notably, the complaint sought the imposition of a constructive trust on the value of the assets held by the principal. The Court concluded that the principal was liable for the employer's withdrawal liability up to the extent of the asset transfers and exercised its equitable powers under ERISA to impose a constructive trust on the distributed assets for the benefit of the pension fund. Id. at 1295-96.

12. To establish constructive fraud, courts will examine whether the employer made the transfer without receiving reasonably equivalent value in exchange for the transfer and: (1) was engaged or about to engage in a business transaction for which the remaining assets of the employer were unreasonably small; or (2) intended to incur, or believed or reasonably should have believed that it would incur, debts beyond its ability to pay as they became due. *Central States, Southeast and Southwest Areas Pension Fund v. TAS Investment Company LLC,* 2013 WL 1222042 (N.D.Ill. 2013)(discussing Michigan Uniform Fraudulent Transfer Act).

13. *Central States, Southeast and Southwest Areas Pension Fund v. TAS Investment Company LLC,* 2013 WL 1222042 * 12 (N.D.Ill. 2013)(citations omitted).

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