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Bankruptcy Law Updates and Analysis



# Seventh Circuit Holds Companies Liable for Insolvent Affiliate's Pension Obligations

#### January 27, 2012 by Stephen Johnson

The Seventh Circuit Court of Appeals recently affirmed a district court decision holding that two limited liability companies were jointly and severally liable for the pension obligations of a third, insolvent affiliate that had ceased making contributions to a multiemployer pension fund. Central States, Southeast and Southwest Areas Pension Fund v. SCOFBP, No. 10-3633 (7th Cir. Dec. 27, 2011).

The Multiemployer Pension Plan Amendments Act of 1980 (the "MPPAA") requires employers who withdraw from a multiemployer pension fund to pay their share of liability resulting from their withdrawal. Under the MPAA, "all employees of trades or businesses (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." 29 U.S.C. § 1301(b)(1). Thus, an affiliate and a withdrawing employer will together be treated as a single employer, and the non-withdrawing affiliate will be jointly and severally liable for the pension obligations of the withdrawing employer if the affiliate is a "trade or business" that is "under common control" with the employer.

In <u>SCOFBP</u>, the three defendant affiliates were all part of one larger set of business entities and off-shore trusts controlled by one individual. In 2001, one of those affiliates, SCOFBP, LLC, was rendered insolvent and discontinued its contributions to the plaintiff pension fund. As a result, SCOFBP incurred withdrawal liability under the MPPAA for unfunded pension benefits. The pension fund asserted that SCOFBP's two solvent affiliates, for-profit LLCs that owned real property leased to SCOFBP and an unaffiliated third party, were liable for the withdrawing entity's pension obligations because the affiliates were "trades or businesses under common control" with SCOFBP.

The United States District Court for the Northern District of Illinois granted summary judgment in favor of the pension fund, finding (1) that the two solvent affiliates constituted "trades or businesses" under the MPPAA and (2) that the two solvent affiliates and SCOFBP were under "common control" as defined in the MPPAA. The three defendant affiliates appealed. Finding the material facts in the case to be undisputed, the Seventh Circuit reviewed the district court's decision using a "clearly erroneous" standard.

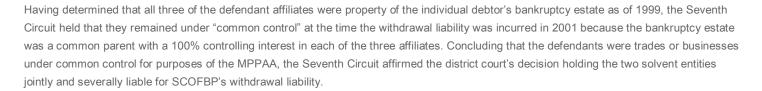
In determining whether the two solvent affiliates constituted "trades or businesses" under the MPPAA, the Seventh Circuit applied the test set forth in Commissioner v. Groetzinger, 480 U.S. 23 (1987), which considered whether the entity in question engaged in an activity with continuity and regularity for the primary purpose of income or profit. Here, the defendants argued that the solvent affiliates established themsleves as vehicles for personal investment unrelated to SCOFBP's commercial operations. The Seventh Circuit rejected this argument, however, finding that the two entities qualified as "trades or businesses" under the Groetzinger test on account of their activities, which included leasing property to SCOFBP, earning rental income, claiming business-income deductions on federal tax returns, obtaining federal employer identification numbers and retaining legal, management and accounting professional to provide services.

The Seventh Circuit then turned to the issue of "common control." The MPPAA identifies three circumstances in which a group of trades or businesses may be deemed to be under common control: a parent-subsidiary group, a brother-sister group, or a "combined" group consisting of both parent-subsidiary and brother-sister relationships. Here, the Seventh Circuit found that SCOFBP and its two solvent affiliates were under the common control of one individual at the time SCOFBP incurred the withdrawal liability in 2001. That individual filed for bankruptcy protection in 1999. Although the individual owned the three defendant affiliates through a series of business entities and foreign trusts, the bankruptcy court presiding over the individual's chapter 11 proceedings found that certain transfers made by the individual in constructing his complex web of business entities and foreign trusts had been fraudulent. As a result, all trust assets, including the ownership interests in the two solvent affiliates, were deemed to have belonged to the individual at the time of his bankruptcy filing and were therefore estate property.

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Employers and their corporate affiliates should take note of the Seventh Circuit's ruling, which makes clear that formal corporate separateness may be insufficient to insulate one company against liability under the MPPAA for its affiliate's unpaid pension obligations. Such shared liability could saddle a company with significant, previously unforeseen obligations. Accordingly, companies should take some care to evaluate their potential MPPAA liability even if they themselves do not currently fund a pension.