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Am I My Brother/Sister Corporation's Keeper: The Right To Contribution for Pension Plan Underfunding

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This article discusses the issues surrounding a right of contribution for PBGC liability between controlled group members.

The current economic situation has created the perfect storm in terms of the funding of defined benefit (DB) pension plans. This is particularly true for DB pension plans attempting to terminate and purchase annuities to fund all accrued benefits. The value of the assets in plans has fallen precipitously; many have declined 30-40 percent. The 100 largest U.S. pensions declined by 26 percent in 2008 and were about 79 percent funded versus being overfunded in 2007. While the markets appear to have improved since the end of 2008, many US pension plans remain largely underfunded. Furthermore, with interest rates at low levels, the cost to purchase annuities to fund benefits has risen dramatically. The same is true with individuals in 401(k) plans who have seen their account balances decrease by 40 percent or more.

Due to the crisis in the financial sector, many corporate conglomerates that are in financial trouble are in the process of selling business units and subsidiaries in order to raise capital or because the sister corporations do not fit in to the conglomerate's recovery plan. Many of these conglomerates maintain one or more DB plans that are underfunded. This raises the issue of the potential liability of the sold subsidiaries for plan underfunding, particularly if the underfunded plan is terminated in a distressed termination. The Employee Retirement Income Security Act of 1974 (ERISA) provides that liability to the Pension and Benefit Guaranty Corporation (PBGC), as a result of a DB plan's distress termination or involuntary termination, is joint and several for any member of the plan sponsor's controlled group on the plan termination date.[1] Accordingly, the PBGC may seek all of a plan's unfunded benefit liabilities from any member of the plan sponsor's

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controlled group — whether or not a particular member's employees participated in the terminated plan. The definition of "controlled group" is broadly defined and is based upon voting power or value as discussed below.

If the PBGC collects the entire termination liability from one member of the controlled group, does that one member have the right to seek contribution from other members of the controlled group? When a controlled group of companies includes only entities that are related to each other outside the definition of "controlled group," seeking contribution from other members may not be an issue as members of the group may have the same interest and consider themselves part of the same "family." Exceptions to this exist when one or more members of the controlled group are not 100 percent owned and thus there are minority owners. Another exception is when some, but not all, members of the controlled group file for protection under the bankruptcy laws. When a member of the controlled group leaves the controlled group following a plan termination, this can become a significant issue.

This article discusses the current state of the law on the right of contribution for PBGC liability amongst controlled group members. As will be discussed below, the existing law on the subject is not well developed, and with the increasing number of bankruptcies and sales of subsidiaries, the decrease in value of plan assets, the increase in plan underfunding[2] and the increasing number of pension plans being terminated,[3] the courts may soon need to revisit the issue of whether there exists, and if so any limits to, a right of contribution for PBGC liability amongst controlled group members.

By way of background, ERISA provides that a controlled group of companies includes a plan's sponsor and any entities under the common control of the same sponsor. To determine whether entities are under common control, ERISA relies on Internal Revenue Code (the Code) Sec. 414 and its accompanying regulations.[4] These regulations generally provide tests for parent-subsidiary groups (a chain of organizations connected with a common parent if the organizations are at least 80 percent owned by another organization in the chain),[5] brother-sister groups (two or more organizations which are at least 80 percent owned by the same five or fewer persons and are also more than 50 percent owned by the same five or fewer persons, taking into account each person's ownership only to the extent that such ownership is identical with respect to each organization)[6] and combined groups (three or more organizations if each is a member of either a parent-subsidiary or brother-sister controlled group and at least one of the organizations is the common parent organization of a parent-subsidiary group and is also a member of a brother-sister group).[7] Among other areas of ERISA and the Code, the controlled group rules come into play when determining liability for a plan's distress or involuntary termination. ERISA Section 4062 provides that, on the date a plan is terminated, any person who is the plan's sponsor or a member of the sponsor's controlled group will incur liability for the terminated plan.[8] Furthermore, the liability of the plan sponsor and its controlled-group members will be joint and several. The amount owed to the PBGC by controlled-group members in connection with a distress or an involuntary termination is the total amount of the unfunded benefit liabilities (as of the termination date) to all participants and beneficiaries under the plan, plus interest calculated from the termination date.[9]

Right of Contribution Among Controlled-group Companies for PBGC Liability

ERISA does not expressly address whether members of a controlled group of companies have a right of contribution against other members with respect to joint and several PBGC liability. A review of secondary sources by these authors found two articles on the issue of whether a member of a controlled group that satisfied liability to the PBGC has a right of contribution from other members of the controlled group.[10] The articles state that there is no case law or guidance directly on point and the issue is unclear.

In the case of *In re Chateaugay Corporation*,[11] the creditors of one of the Chapter 11 debtor-subsidiaries (referred to herein as "LTV Aerospace") argued that they had standing to challenge an earlier bankruptcy court order authorizing another debtor-subsidiary (referred to herein as "LTV Steel") to make payments to one of its pension plans. The LTV Aerospace Committee argued that it had standing to contest the order because the order directly affected its pecuniary interest. LTV Aerospace had filed a claim for contribution for unfunded pension-liability payments, based on its membership in the controlled group of companies with LTV Steel, and was therefore a creditor of LTV Steel. Although the court did not decide the issue because the claim was prospective, it noted in dicta that the LTV Aerospace Committee would not "appear" to have had a claim for contribution. The LTV Aerospace Committee cited *Chemung* (described in more detail below) as support for its position. The *Chateaugay* court, however, distinguished *Chemung* as a case dealing with the right of contribution among co-fiduciaries. It stated that "[w]hile contribution among co-trustees has been an integral part of trust doctrine for well over a century, there is no legal precedent regarding a right of contribution among controlled group members for unfunded pension liability."[12]

There have been cases dealing with the right of contribution involving co-fiduciary liability, which is another area of ERISA in which joint and several liability exists. This body of case law, while not directly analogous to right of contribution for PBGC liability, may be instructive as to how a court would approach the PBGC liability question.

Right of Contribution among Co-fiduciaries

ERISA provides for the liability of one fiduciary in respect of a co-fiduciary's breach in certain circumstances.[13] Federal courts have examined the issue of whether there is a right of contribution among co-fiduciaries for damages arising from a breach of fiduciary duty. These decisions may be distinguished from the issue of whether there is a right of contribution among controlled-group members for PBGC liability. The court decisions that find a right of contribution rely on the fact that the courts were authorized to develop a federal common law, based on the law of trusts (which includes fiduciary concepts), in order to accompany ERISA's statutory scheme. PBGC liability, however, is unique to ERISA law. Although several courts have found that there is a right of contribution among co-fiduciaries because fiduciary issues are central to the law of trusts, the federal circuits are split on the issue.

In *Toledo Blade Newspaper Unions-Blade Pension Plan v. Investment Performance Services, LLC*,[14] the court held that ERISA did not provide for the remedy of contribution by co-fiduciaries for damages arising from a breach of fiduciary duty and, accordingly, granted the plaintiffs' motions to dismiss the defendants' counterclaims for contribution and indemnification. The court stated that the Second and Seventh Circuits,[15] as well as numerous district courts, have held that the remedy of contribution

among co-fiduciaries exists under ERISA, while the Ninth Circuit and several district courts (including three in the same district as the *Toledo* court) have held that there is no right of contribution among co-fiduciaries under ERISA. Citing *Williams v. Provident*,[16] the court summarized the arguments on each side as follows:

• *Right of contribution exists under ERISA*: "[These courts] begin by noting that courts are to be guided by principles of traditional trust law when developing federal common law under ERISA, and that trust law generally includes a right to contribution among fiduciaries. These courts then reason that, because traditional trust law includes contribution, a right to contribution exists under ERISA's federal common law." In addition, they reason that "disallowing claims for contribution will frustrate ERISA's purpose of deterring plan abuse by allowing breaching fiduciaries to escape the consequences of their actions."
• *No right of contribution exists under ERISA*: These courts "maintain that Congress' silence on the question of contribution and indemnification, in the context of such an expansive and intricately drafted statute like ERISA, indicates an intent to preclude those remedies." In addition, they reason that "ERISA provides remedies only for beneficiaries of a plan, or for a plan itself, to recover lost monies from the fiduciaries who caused the losses and that ERISA does not provide relief for the fiduciaries themselves."

The *Toledo* court described ERISA as a "comprehensive and reticulated statute" and, although trust law was meant to aid in interpreting ERISA, the exclusion of the remedy of contribution from ERISA should be presumed to be deliberate. Moreover, it found that a plan participant's interest (which is the focus of ERISA) would not be furthered by permitting the defendant to include a counter-claim against the plaintiff for the same breach of fiduciary duty that the plaintiff was seeking to enforce against the defendant.

In contrast, the Second Circuit is of the view that a right of contribution among co-fiduciaries exists under ERISA's federal common law. In *Chemung Canal Trust Co. v. Sovran Bank/Maryland*,[17] the court reversed a district court's holding that there could be no cause of action for contribution or indemnity under ERISA. It reasoned that, although ERISA does not expressly provide a right of contribution among co-fiduciaries, that omission does not necessarily preclude the remedy's availability since federal courts are authorized to develop federal common law under ERISA.[18] The court examined trust law because ERISA's fiduciary provisions are based on trust law principles.[19] The court further stated that trust law includes a right of contribution among fiduciaries, and that such right should also be recognized under ERISA.

The court was not persuaded by the defendants' arguments that, since the Supreme Court declined to find a right of contribution under other comprehensive federal statutes (*i.e.*, antitrust laws, Title VII and the Equal Pay Act), the court in Chemung should similarly find no such right under ERISA, which is also a comprehensive federal statute. The Chemung court reasoned that the Supreme Court made clear that, unlike in other bodies of federal law with respect to which federal courts are authorized to develop a federal common law (*e.g.*, admiralty and labor law), no such authority exists for the statutes in question. The development of federal common law with respect to ERISA, however, has been authorized. Moreover, it was not persuaded by the argument that the omission of a contribution right in ERISA leads to the conclusion that Congress intended that the right not be available. The court explained that ERISA was designed for the purpose of protecting plan participants and beneficiaries

and consequently is silent on the issue of liabilities among co-fiduciaries. It reasoned that this silence did not necessarily indicate an intentional omission, but instead was an area on which Congress did not focus and that should be filled in by the federal courts through the development of a federal common law.

Conclusion

No controlling case or guidance was found on the subject of whether there is a right of contribution among controlled group members with respect to PBGC liabilities. While not deciding the issue, the *Chateaugay* court suggested in dicta that there is no right of contribution for liabilities to the PBGC. There are many cases discussing the issue of a right to contribution among co-fiduciaries for joint and several liability, although that issue is also unclear because of the current circuit split. Even if the circuits were in agreement on the co-fiduciary issue, it may not be analogous to the controlled group issue because there is no controlled group concept in traditional trust law. As explained above, in *In re Chateaugay*, the Southern District of New York, while not deciding the issue, noted the co-fiduciary contribution position but distinguished its applicability to PBGC liability because of the different natures of the two types of liabilities.

It would appear that courts adopting the Ninth Circuit's approach to co-fiduciary right of contribution would similarly find that there is no right of contribution for PBGC liability. Courts adopting the Second or Seventh Circuits' approach to co-fiduciary right of contribution should also find that there is no right of contribution for PBGC liability since their co-fiduciary decisions are based on ERISA's basis in traditional trust law, which is not relevant to PBGC liability. The PBGC can be expected to take the position that there is a right of contribution if that allows it to more easily collect what is due to it. It has been mentioned by others that in some bankruptcy proceedings it has taken an aggressive position on its right to request contribution.

Endnotes

1. ERISA Section 4062(a).

2. See, *Harvard Secured Creditors Liquidation Trust*, 568 F.3d 444, a case dealing with a tax dispute that arose during the bankruptcy proceedings relating to Harvard Industries, Inc. and its related companies. In this case, the court reversed a district court's ruling and affirmed a bankruptcy court's finding that contributions made to Harvard Industries' pension plans pursuant to a PBGC settlement agreement (i) arose under ERISA and (ii) should be treated as arising during the years when the underfunding liability arose, rather than when the payments were made pursuant to the settlement agreement. At issue in the case was, among other things, whether payments that Harvard Industries made to its pension plans pursuant to a PBGC settlement agreement constituted "specified liability losses" and thereby qualified for a ten-year net operating loss carry-back under Code Sec. 172 (as the statute read in 1996). Code Sec. 172, as it read in 1996, required this type of liability to "arise" out of a federal or state law, and also required that the "act giving rise to such liability" occur at least three years before the loss. The IRS argued that the payments were not "specified liability losses" because the payments were made as a result of choices made by Harvard Industries (and therefore were not "rooted in federal law"), and because the "act" in question was a choice to enter into a settlement agreement with the PBGC in 1994, which would mean that the act occurred less than three years before the payments were made in 1996. The court held, however, that the connection between payments made pursuant to a PBGC settlement agreement and Harvard Industries' obligations under ERISA were "sufficiently direct that it may be said to 'arise under federal law.'" In addition, it found that the payments should be treated as arising when the funding obligation arose (i.e., in 1992 and 1993) rather than at the time of settlement of that obligation.

3. *See No Guarantees: As Pension Plans Crumble, Can PBGC Deliver? Hearing before the Senate Special Comm. On Aging*, 111th Cong. (May 20, 2009) (testimony of Vincent K. Snowbarger, acting director, Pension Benefit Guaranty Corporation),

at p. 7, 9, available online at http://aging.senate.gov/hearing_detail.cfm?id=313310& ("… declines in the stock market have reduced the value of assets held by DB plans and have caused the unfunded liabilities of most DB plans to increase substantially."; "During the first six months of FY 2009, a time when the economy was weakening, PBGC took in about the same number of plans as in all of FY 2008 and nearly four times the number of participants…").

4. ERISA Section 4001(a)(14).
5. Reg. §1.414(c)-2(b).
6. Reg. §1.414(c)-2(c).
7. Reg. §1.414(c)-2(d).
8. ERISA Section 4062(a).
9. ERISA Section 4062(b)(1)(A).
10. See Kalas, John J., *Termination Liability for Single Employer Pension Plans*, 112 Banking L.J. 24, 28. (1995) ("Congress has not explicitly addressed whether contribution is permitted, and accordingly, it is unclear if control group members, in turn, have rights of contribution for the amount paid to the PBGC."); Phelan, Robin E., *Employer/ Employee Problems in Bankruptcy Cases,* 649 Practicing Law Inst. Com. Law and Prac. Course Handbook Series 43, 77-83 (1993) ("It is unclear whether a member of the control group that satisfies the unpaid liability has a right of contribution from the plan sponsor or other members of the control group ... ."; "... no court has addressed the precise issue of whether a controlled group member has an implied right to sue for reimbursement from the other controlled group members under Title I ... or Title IV of ERISA …").
11. 141 B.R. 794 (S.D.N.Y. 1992).
12. *Id*. at 801. Also in support of finding no right of contribution among controlled group members (if it were going to decide the issue), the *Chateaugay* court cited *PBGC v. Ouimet Corp.*, 711 F.2d 1085 (1st Cir. 1983) *cert. denied*, 104 S.Ct. 393 (1983). That case dealt with a terminated pension plan sponsored by two bankrupt entities in whose controlled groups were non-bankrupt entities. The solvent entities were in essence arguing that there were two classes of defendants: direct employers (who were bankrupt) and the other remaining members of the group. They argued that the remaining members were only secondarily liable. Because that is not how controlled group liability works, the court rejected that argument. It acknowledged that ERISA "does not explicitly allocate liability among controlled group members," and also found that allocating liability would cut "against the language and policies of the statutory scheme," which works to limit bankruptcy estates as a source of payment to the PBGC.
13. ERISA Section 405(a).
14. [US-DIST-CT, PENSION-CASES ¶ 148,685] 448 F. Supp. 2d 871 (N.D. Ohio 2006).
15. But see *Summers v. State Street Bank & Trust Co.*, 453 F.3d 404, 413 (7th Cir. 2006) (stating in dicta that the issue of whether there is a right of contribution among ERISA defendants is open in the Seventh Circuit and that, although the court in *Alton Mem'l Hosp. v. Metro. Life Ins. Co.*, 656 F. 2d 245, assumed ERISA defendants have a right of contribution, the court did not actually discuss the question).
16. 279 F. Supp. 2d 894 (9th Cir. 1989).
17. 939 F. 2d 12 (2d Cir. 1991), *cert. denied*, 112 S.Ct. 3014 (1992).
18. *Citing Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101, 110 (1989).
19. *Citing id*. at 110.

This article is intended only as a general discussion of these issues. It is not considered to be legal advice. We would be pleased to provide additional details or advice about specific situations. For additional information on this important topic, please feel free to call upon your Dewey & LeBoeuf relationship partner.

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