Federal court imposes personal liability for multiemployer pension plan liabilities

By Paul A. Kasicky

SUMMARY
A recent case highlights the risk of personal liability for multiemployer and other defined benefit pension plan liabilities. Owners of closely held corporations that contribute to multiemployer or single employer defined benefit pension plans (DB Plans) should assess and, if possible, take some reasonably uncomplicated actions to reduce the personal liability risk.

The case, Central States, Southeast and Southwest Areas Pension Fund v. Nagy, No. 11-3055, 2013 WL 1706413 (7th Cir. Apr. 22, 2013) found an individual personally liable for the almost $3.7 million withdrawal liability owed to a multiemployer pension plan by a contributing corporation. The risk is equally applicable to single employer defined benefit pension plan liabilities and PBGC premium obligations. While the case does not forge any significant new developments, it serves as a reminder to owners of closely held corporations that contribute to multiemployer or single employer DB Plans to assess and, if possible, take action to reduce the personal liability risk.

The personal liability risk addressed in Nagy involved an individual having an ownership interest in a corporation that was assessed a withdrawal liability by a multiemployer pension plan. The individual also had an interest in other income activities including leasing of property to the corporation and as an independent contractor to an unrelated business. The primary issues in the case involved whether each of the other income activities constituted a trade or business and the court held the other activities did constitute trades or businesses. Under long established law, businesses having sufficient ownership or service relationships (an ERISA related employer group) have joint and several liability for many DB Plan liabilities, including multiemployer pension plan liabilities, of any of the ERISA related employers. As a result, due to sufficient common ownership among the corporation and the other businesses (in this case the individual appears to have had 100 percent of the corporation and was the sole proprietor and deemed 100 percent owner of the leasing and independent contractor businesses), the corporation and other businesses constituted a common control group (one form of an ERISA related employer group) for purposes of joint and several liability for the withdrawal liability. Further, since a proprietor or independent contractor is obligated for liabilities of the proprietorship or self employment, the withdrawal became a personal liability of the individual.

One of the primary issues in the appeal was whether the leasing activity constituted a trade or business. Generally, the question becomes a determination as to whether the leasing activity is merely a passive investment or an active trade or business. The rule applied by the 7th Circuit Court deciding Nagy is that the leasing of property to the corporation that incurred the ERISA liability will be deemed to be a trade or business. There is some inconsistency in decisions regarding whether particular leasing activities constitute a trade or business rather than a passive investment. However, any such activity poses a personal liability risk, particularly if the leasing is to the corporation responsible for creating the ERISA liability.
While *Nagy* involved withdrawal liability to a multiemployer pension plan and proprietorship and independent contractor facts, the personal liability risk that it illustrates has broader application. In addition to multiemployer pension plan withdrawal liability, the risk extends to other DB Plan liabilities including obligations related to single employer DB Plan contributions, termination underfunding and PBGC premiums. The risk of personal liability also extends to a partner having general liability under applicable state business law. Therefore, if a proprietorship or partnership is a trade or business and it becomes liable for a DB Plan liability incurred by another member of its ERISA related employer group, the individual proprietor, independent contractor or general partner will incur personal liability for the DB Plan liability.

The personal liability risk could arise directly from a proprietorship or partnership sponsoring a DB Plan rather than one sponsored by another member of an ERISA related employer group. However, that risk is generally recognized and unlikely to occur. As in *Nagy*, the risk generally would arise in a situation involving an ERISA related employer group where an individual owner fails to recognize the personal liability risk that can arise when an ERISA related employer group member conducts activities in the form of a general partnership, proprietorship or independent contractor.

The principal lesson from *Nagy* is that personal liability is a risk if (i) an individual conducts a trade or business as a general partner or sole proprietor, including provision of services as an independent contractor or conducting sufficient leasing activities, (ii) that trade or business is a member of an ERISA related employer group because of sufficient ownership or service relationships and (iii) any member of the ERISA related employer group has a DB Plan liability. A shareholder of a closely held corporation that has or has the potential for having any DB Plan liability should examine the shareholder’s other income activities to assess the risk of becoming personally liable for any DB Plan liability of the corporation. Where there is a possible risk, consideration should be given to converting the general partnership or proprietorship to a corporate or limited liability company form.

If the risk is present, the individual exposed to personal liability risk should not expect that the existence of an ERISA related employer group or general partner or proprietor businesses will remain undisclosed. As to a withdrawal liability to a multi-employer pension plan, one type of DB Plan liability, the fund will typically request information, including tax returns, including from an owner, seeking to identify ERISA related employer group members. Of particular interest will be Schedule C, Profit and Loss from Business (Sole Proprietorship), which would include independent contractor income, Schedule E, Supplemental Income and Loss (including from rental activities, partnerships and trusts) and Schedule F, Profit or Loss from Farming. The same inquiries could be expected if an underfunded plan seeks a distress termination.

While not establishing significant new law, *Nagy* indicates some individuals continue to either be unaware of the personal liability risk or have lost a gamble on a recognized and assumed risk. If the situation might apply to you, feel free to contact us for a careful examination of your situation to accurately assess the personal liability risk.

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