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Client Alert Commentary

Latham & Watkins Benefits, Compensation & Employment Practice May 8, 2017 | Number 2132

Canadian Court Dismisses ERISA "Controlled Group" Claim

Decision creates a substantial barrier to controlled group claims in Canada, may provide a template for other jurisdictions.

Key Points:

- ERISA controlled group liability is joint and several for all members of a pension plan sponsor's controlled group, including foreign members.
- Little precedent exists on the question whether controlled group claims are viable outside the US.
- Decision holds that the controlled group claim fails in Canada as a matter of law.

On May 1, 2017, the Supreme Court of British Columbia (the Court) handed down its decision in *Walter Energy Canada Holdings, Inc. (Re)*, 2017 BCSC 709 [hereinafter *Walter Canada*]. The decision holds that an ERISA controlled group claim fails because the claim raises a question of corporate personality — namely, whether corporate separateness may be disregarded to impose a plan sponsor's liability on its affiliates — and that the law of the place of incorporation, rather than US law, applies to such questions. Because the laws of the places of incorporation, British Columbia and Alberta, do not include ERISA, and because ERISA's controlled group provisions were the sole basis for liability, the claim fails. The decision creates an important guide to the limits of controlled group liability in Canada, and potentially in other jurisdictions guided by the decision.

Why the case is important – testing the limits of "controlled group" claims

The Employee Retirement Income Security Act of 1974, as amended (ERISA) imposes joint and several liability on a plan sponsor and any members of its controlled group for many pension-plan liabilities, including termination liability for underfunded single-employer plans and withdrawal liability for multiemployer plans. In general, the term controlled group refers to a group of corporations or unincorporated entities engaged in a "trade or business" with at least 80% common ownership. A controlled group may include parent-subsidiary relationships in which the parent owns (or is deemed to own) 80% or more of the voting power or value of the stock of a subsidiary as well as certain affiliate relationships.

ERISA's controlled group provisions have the potential to transform a relatively valueless claim against an insolvent plan sponsor into a valuable claim against the larger corporate group. Given the extent of pension-plan underfunding, which analysts estimated at US$325 billion at the end of 2016 for the 410 Fortune 1000 companies sponsoring plans, the potential impact of controlled group claims on recoveries, and on corporate group liabilities, is highly significant.[1]

Historically, ERISA controlled group claims have tended to stop at the US border. Although foreign controlled group members are technically included in the controlled group definition under ERISA, neither the Pension Benefit Guaranty Corporation (PBGC) (for single-employer plan termination liability) nor multiemployer plans (for multiemployer plan withdrawal liability) had pursued foreign controlled group members with respect to the pension plans of their US affiliates. However, in recent cases, the PBGC and multiemployer plans have taken a more aggressive approach both in US courts and elsewhere.

Within the US, the PBGC and certain multiemployer plans have attempted to obtain personal jurisdiction over foreign controlled group members.[2] The PBGC ultimately prevailed in *Pension Benefit Guaranty Corp v. Asahi Tec Corp*., winning summary judgment on the question of whether the court had personal jurisdiction over Asahi Tec, the Japanese parent of bankrupt Metaldyne Corporation.[3] In that case, the court reasoned that specific jurisdiction existed because Asahi Tec had "purposefully directed activity towards the U.S." through its purchase of Metaldyne, including by conducting an extensive review of Metaldyne's pension liabilities. In addition, the court found that Asahi Tec had assumed responsibility for the controlled group obligations by, among other things, including controlled group liability representations in the acquisition documents. *Asahi Tec* thus stands (alone) for the proposition that foreign controlled group members may be subject to suit in the United States at least in circumstances showing a high degree of activity directed into the United States, combined with express awareness of the potential controlled group liabilities.[4]

The ability of the PBGC or a plan to pursue foreign controlled group members or their assets *outside* of the United States has remained less certain. When American Airlines entered bankruptcy in 2011[5] and threatened to seek court authorization to terminate its pension plans, the PBGC took the first opportunity — American's failure to make most of its plan payments in January 2012 — to file more than 70 liens on foreign assets, predominantly in Latin America. Because American and the PBGC ultimately settled, it is not clear whether the PBGC would have succeeded in its pursuit of the foreign assets.

Until the *Walter Canada* decision, there appears to have been no reported decision in a foreign jurisdiction addressing the viability of ERISA controlled group claims abroad. As a result, *Walter Canada* has become the only current guide to ERISA controlled group claims in foreign jurisdictions. As discussed below, the decision erects a substantial barrier to such claims in Canada, and perhaps elsewhere.

Background to the decision – Walter Energy's US & Canadian bankruptcies

The Walter Energy Group is an international coal production and export company. Walter Energy, Inc. (n/k/a New WEI, Inc.) (Walter Energy US) is the US-based parent corporation of the Walter Energy Group. One of its subsidiaries, Jim Walter Resources, Inc. (Walter Resources), was the sole Walter Energy Group participant in the "1974 Plan," a multiemployer pension plan established in 1974 pursuant to the collectively bargained National Bituminous Coal Wage Agreement of 1974, which was last amended and executed in 2011 (the 2011 CBA).

Also in 2011, and after execution of the 2011 CBA, Walter Energy US incorporated Walter Energy Canada Holdings, Inc. (Walter Canada) and, through Walter Canada, acquired the coal mining operations of Western Coal Corporation by purchasing of all of its outstanding common shares. Afterwards, the Walter Energy Group engaged in a series of internal restructurings to organize into geographical business segments: the Walter US Group, the Walter Canada Group and the Walter UK Group. As a result, all US assets were transferred to Walter Energy US, which remained the parent entity of the Walter Energy Group.

On July 15, 2015, Walter Energy US and certain of its subsidiaries, including Walter Resources, commenced Chapter 11 proceedings in the Northern District of Alabama.[6] In October 2015, the 1974 Plan filed a proof of claim for the anticipated withdrawal liability of Walter Resources in the amount of US$904 million. As anticipated, the bankruptcy court ultimately authorized Walter Resources to reject the 2011 CBA and thereby to withdraw as a participating employer from the 1974 Plan. In the same order, the bankruptcy court declared that any sale of the Walter debtors' assets would be free and clear of liabilities under the 2011 CBA. The bankruptcy court approved a sale of the debtors' assets, which closed on April 1, 2016, causing all contributions by Walter Resources to the plan to cease — and the withdrawal liability to arise.

In late 2015, Walter Canada and certain of its subsidiaries had sought, and received, protection under the Companies' Creditors Arrangement Act (CCAA) in Canada, creating a parallel bankruptcy proceeding in Canada. After the sale proceedings concluded in the US bankruptcy, the 1974 Plan filed a claim in the CCAA proceeding, seeking to recover withdrawal liability from Walter Canada and its subsidiaries exclusively on the theory that they were members of Walter Resources' controlled group under ERISA. If the claim were allowed, it would swamp all other unsecured claims in the CCAA proceeding; if it were disallowed, all other unsecured claims would recover in full, including the claims of Canadian unionized coalworkers, but no funds would be paid to the 1974 Plan with respect to its unsecured claim.

The Court's decision – Canadian law applies, and does not include ERISA

Setting aside debates over procedure, the parties addressed three main questions: (1) whether US law (*i.e.*, ERISA) or the law of the place of incorporation, should apply to a claim seeking to impose a plan sponsor's liability on affiliate corporations; (2) whether application of ERISA under the circumstances would constitute an impermissible extraterritorial application of ERISA; and (3) whether application of ERISA under the circumstances would be contrary to Canadian public policy. Because the Court held that ERISA does not apply, it did not address the second and third questions.

To begin its analysis of the applicable law, the Court applied Canadian choice of law principles. The Court concluded that the Canadian choice of law analysis required first characterizing, or classifying, the legal issue requiring adjudication, then considering the "connecting factor" tying the issue to a particular legal system, and then applying the chosen governing law.

In this case, as the court recognized, the critical step was the first one. Walter Canada asserted that the central issue was one of the law of corporations or "an issue of legal corporate ... status or personality," because the 1974 Plan's claim was based entirely on ERISA's controlled group provisions, which would impose liability solely on the basis that Walter Resources and the Walter Canada entities were both indirectly owned by Walter Energy US. If accepted, this characterization would lead directly to defeat of the ERISA claim, because under Canadian choice of law principles the predominant connecting factor between issues of corporate personality and a given legal system is the place of incorporation, and the laws of the places of incorporation — British Columbia and Alberta — do not include ERISA.

The 1974 Plan asserted that the central issue was one of the "law of obligations." In other words, the claim was essentially contractual, arising from obligations under the 2011 CBA. The Court disagreed, stating that the 1974 Plan had no "contractual expectations" in relation to the Walter Canada entities, which were not signatories to the 2011 CBA. Any expectations in relation to the Walter Canada entities would have been "statutory expectations."

Instead, the Court agreed with Walter Canada that the ultimate question was one of "separate legal existence or personality," because the alleged liability arose solely from the ERISA's provisions, which

"impose[d] liability by ignoring separate corporate personalities and effectively amalgamating, consolidating, or collapsing 'common control' entities into a single 'employer' for any withdrawal liability of any other entity within that group."

Having concluded that it was addressing a question of corporate personality, the Court then held that such questions are connected to, and governed by, the law of the place of incorporation of the corporation. Here, all of the Walter Canada entities were incorporated in British Columbia or Alberta. "As a result, British Columbia and Alberta law [would] determine whether the separate legal personalities of the Walter Canada Group entities can be ignored." Finally, the Court applied the relevant law in summary fashion, stating: "ERISA is not part of British Columbia or Alberta law. Accordingly, the 1974 Plan's claim must fail for that reason."

Guidance – ERISA claims in foreign jurisdictions after *Walter Canada*

Walter Canada is an important decision that calls into question the ability of claimants (which may include multiemployer plans as well as the PBGC, with respect to single-employer plans) to pursue ERISA controlled group claims in Canada, and in other jurisdictions persuaded by the Court's reasoning. The Court applies a cogent legal framework to foreclose a claim that may be difficult for any foreign court to accept, *i.e.*, a claim based on a US statutory provision that imposes liability in derogation of general principles of corporate separateness — and in aid of a US statutory insurance scheme. Especially in the absence of other relevant authority, future courts in other jurisdictions may take note, and the failure of the ERISA claim in Canada, a jurisdiction whose courts work often and closely with their US counterparts, especially in matters of insolvency, could be a strong indicator that such claims will face challenges elsewhere.

The Court was careful to state that it was not issuing a "blanket denial" of ERISA claims, and it left open the possibility of claims grounded in, for example, tort and fraud. The Court further stated that the decision would not imperil principles of international comity and, in particular, that it was not being asked to decide, and was offering no opinion on, whether it would enforce a US judgment entered against a Canadian entity for withdrawal liability. However, tort and fraud claims presumably would not require ERISA for their effectiveness, and US judgments would first require US personal jurisdiction, which will likely remain elusive even after *Asahi Tec*. In short, while the Court was careful to leave the door ajar, the opening may prove narrow.

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Endnotes

1 Willis Towers Watson, *After a few ups and downs, corporate pension funding levels showed little change in 2016* , February, 2017, *available at* https://www.towerswatson.com/en/Insights/Newsletters/Americas/Insider/2017/02/corporate-pension-funding-levels-showed-little-change-in-2016.

2 *See GCIU-Employer Retirement Fund v. Goldfarb Corp.*, 565 F.3d 1018 (7th Cir. 2009); *PBGC v. Satralloy, Inc.*, 1993 U.S. Dist. LEXIS 21422 (S.D. Ohio Aug. 6, 1993).

3 839 F. Supp. 2d 118 (D.D.C. 2012).

4 The only reported decision citing *Asahi Tec* refused to apply its logic in similar circumstances, finding the case "unpersuasive and distinguishable" and dismissing the claims of the multi-employer fund against the foreign parents of the defunct US entity. *GCIU-Employer Ret. Fund v. Coleridge Fine Arts*, 154 F. Supp. 3d 1190, 1199 (D. Kan. 2015).

5 *In re AMR Corporation, et al.*, Case No. 11-15463 (Bankr. S.D.N.Y. filed Nov. 29, 2011).

6 *In re New WEI, Inc. f/k/a Walter Energy, Inc.*, Case No. 15-02741 (N.D. Ala. filed July 15, 2016).