

LAW FIRM COMMITS MALPRACTICE BY FAILING TO ADVISE CLIENTS OF CONTROLLED GROUP STATUS, RESULTING IN WITHDRAWAL LIABILITY ASSESSMENT

Hodgson Russ Employee Benefits Newsletter
October 28, 2017

Practices & Industries

Employee Benefits

Businessmen Neal Cohen and Darren Chaffee contacted the Michigan law firm of Jaffe Raitt Heuer & Weiss (“Jaffee”) for advice regarding liabilities associated with the potential purchase of LSI Corporation (“LSI”). In particular, Cohen and Chaffee had learned that LSI’s union employees participated in an underfunded multiemployer pension plan and wanted to “be sure that we aren’t personally liable or put our other assets/companies at risk” regarding estimated pension withdrawal liability of \$3.9 million.

Weiss, the partner who managed the relationship with Cohen and Chaffee, explained that withdrawal liability would only be of concern if the two had “common ownership” interests that constituted a controlled group. Chaffee and Cohen stated that they did not have common ownership of any entities, and Weiss assured them that they could not be held liable for the pension withdrawal liability. Chaffee and Cohen purchased LSI and after three years of financial struggles to sustain the company, LSI terminated its entire union workforce and was assessed withdrawal liability of \$3.3 million.

Cohen and Chaffee filed a malpractice suit against Jaffee. The key legal issue was whether Jaffee breached the standard of care by failing to properly advise its clients about the controlled group rules.

Determining whether businesses are in a controlled group or under common control requires the proper application of a complicated set of rules, and a thorough understanding of the relationships among the businesses and their owners. Whether businesses are under common control depends upon whether they have a parent-subsidary or brother-sister relationship.

Parent-subsidary control exists if one entity possesses at least 80% of the capital or profit interests of the other entity. Two businesses are members of a brother-sister common control group if the same 5 or fewer individuals have a controlling interest and effective control. A controlling interest means the same 5 or fewer individuals together own at least 80% of each business. Effective control means the same 5 or

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fewer individuals have identical ownership across both businesses in excess of 50%, taking into consideration each owner's interest where it is the smallest.

In addition to conducting a complex ownership analysis, controlled groups may be found to exist through "attribution" of ownership. "Attribution" means an ownership interest is deemed to exist by virtue of an indirect relationship. Here, Cohen and Chaffee each owned separate companies and those companies owned another business, SSL Assets. Under the attribution rules, an ownership interest in a company that is held by a partnership or corporation is deemed to be proportionally owned by the partners or owners who hold at least a 5% interest. While Cohen and Chaffee did not have direct ownership of SSL Assets, their separate companies' ownership interest in SSL Assets was deemed to be held by Cohen and Chaffee through "attribution."

Application of the brother-sister and attribution rules resulted a determination that SSL Assets was in a controlled group with financially troubled LSI.

Evidence introduced at trial showed that Weiss failed to gather any information on the ownership structure of the entities in which Cohen or Chaffee had an interest. Moreover, Weiss stated that he did not have a "legally accurate" understanding of the controlled group rules, nor did he understand the specifics of the brother-sister control test or attribution rules.

The jury concluded that Jaffee breached its duty of care in providing legal advice, which caused damages of more than \$6 million to Cohen and Chaffee. However, the jury determined that Cohen and Chaffee could have mitigated their losses, presumably by not investing additional funds in attempting to save LSI. Thus, the jury reduced its award to \$1.7 million for Cohen and Coffee, but awarded damages of \$3.3 million to SSL Assets, the amount of the withdrawal liability.

Cohen v. Jaffe Raitt Heuer & Weiss, P.C., (E.D. Mich., 2017).