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**Pension Trusts Should Not Be Considered Business Trusts for the Purpose of § 109 of the Bankruptcy Code and Thus Not Eligible to be a Debtor under the Bankruptcy Code**

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**INTRODUCTION**

Qualifying as a debtor is the first eligibility requirement for bankruptcy protection under the United States Bankruptcy Code (the “Code”). Failure to satisfy the requirements to be a qualifying debtor forecloses an entity from obtaining bankruptcy relief. Thus, it is crucial that qualifying debtor categories are defined and delineated, particularly for business entities for whom debtor status is not always so clear.

Section 109 of the Code includes “business trust[s]” as a party entitled to bankruptcy relief but excludes other trusts from that definition. While the Code is clear to exclude ordinary trusts from eligibility to be a debtor, it leaves the term “business trust” undefined. Because the Code does not explicitly define the term “business trust,” it has been up left to the courts to come up with a cohesive and uniform interpretation of a debtor under section 109. Courts continue to grapple with how to define “business trust,” and have equivocated on which sorts of trusts should be considered business trusts. The ongoing question of how to define a business trust has impacted the ability of pension trusts to file for bankruptcy. While the pension trusts argue that they should be treated as business trusts for the purpose of debtor eligibility, the courts that have heard their claims have

rejected them and have held instead that pension trusts do not qualify as business trusts for the purpose of section 109.<sup>1</sup>

This memorandum addresses why pension trusts should not be included within the definition of a business trust for the purposes of section 109 of the Code pursuant to the frameworks of the traditional *Morrissey* test, the substantial business activities test, and the *In re Dille Family Trust* analysis.

### **I. Courts Are Divided on How to Define a Business Trust.**

The ability to file a chapter 11 petition for protection under the Bankruptcy Code turns on whether the petitioning party qualifies as a debtor. Thus, how the court defines “business trust” can be dispositive on the matter. Indeed, “the decisions are sharply, and perhaps hopelessly, divided on the meaning of ‘business trust.’”<sup>2</sup>

Section 109 of the Code provides that “only a person ... may be a debtor under this title.”<sup>3</sup> The Code then defines “person,” including under its purview “individual, partnership, and corporation.”<sup>4</sup> “Corporation” is further defined as including a “business trust.”<sup>5</sup> Thus, read together, the Code provides debtor protection only for trusts that qualify as business trusts, giving them the same protections as a corporation, which are treated as persons for the purpose of the Code.<sup>6</sup>

On the other hand, a trust that does not qualify as a business trust is not entitled to debtor protection under Chapter 11.<sup>7</sup> As opposed to business trusts, other trusts are not persons, but rather

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<sup>1</sup> See *In re Cahill*, 15 B.R. 639 (E.D. Penn. 1981); *Catholic School Employees Pension Trust*, 599 B.R. 634 (1st Cir. B.A.P. 2019).

<sup>2</sup> *In re Medallion Realty Trust*, 103 B.R. 8 at 10 (D. Mass. 1989).

<sup>3</sup> 11 U.S.C. 109(a).

<sup>4</sup> 11 U.S.C. 101(41).

<sup>5</sup> 11 U.S.C. 101(9)(a)(v).

<sup>6</sup> See *Morrissey v. Commissioner of Internal Revenue*, 296 U.S. 344 (1935).

<sup>7</sup> See *In re Cahill*, 15, B.R. 639 at 640 (“Business trusts have been included in the definition of corporation .... All other trusts, however, are ineligible for relief in Chapter 11.”).

considered under the definition of “entity,” which, unlike persons, are not entitled to debtor protection. Thus, “except for a ‘business trust’ a trust is not a ‘person’ eligible for relief.”<sup>8</sup>

The early courts construing the Code turned to legislative history, which conclusively stated that “the definition [of ‘person’] does not include an estate or a trust.”<sup>9</sup> So, courts are clear that there is a difference between business trusts and other sorts of trusts, but still unclear on what exactly this distinction is.

#### **A. The traditional *Morrissey* Test and its applicability to pension trusts**

The traditional test for determining whether a trust is a business trust emphasizes intent of the creators of the trust at inception and the formalities used by the creators. The Supreme Court fashioned this test in *Morrissey*, where the Court distinguished between an “association,” which qualifies as a corporation for tax purposes, and a “pure trust,” which does not.<sup>10</sup> While factually distinct, the analysis undertaken by the Court in *Morrissey* is relevant to the question at hand. There, the government argued that there is a distinction between “business trusts on the one side” and “other trusts which are engaged merely in collecting the income and conserving the property against the day when it is to be distributed to the beneficiaries,” and that Congress intended to tax *only* business trusts as corporations.<sup>11</sup> Further, “[s]uch beneficiaries [to an ordinary trust] do not ordinarily ... plan a common effort or enter into a combination for the conduct of a business enterprise.”<sup>12</sup> In contrast, the object of a “business trust” is “not to hold and conserve particular property ... but to provide a medium for the conduct of a business and sharing its gains.”<sup>13</sup>

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<sup>8</sup> *In re Medallion*, 103 B.R. at 10.

<sup>9</sup> *Id.* (quoting H.R.Rep. No 95-595, 95th Cong., 1st Sess. 313 (1977); S.Rep No. 95-989, 95th Cong., 2d Sess. 25 (1978)).

<sup>10</sup> 296 U.S. at 347.

<sup>11</sup> *Id.* at 249 (internal quotations omitted).

<sup>12</sup> *Id.* at 357.

<sup>13</sup> *Id.*

In distinguishing a business trust from an ordinary trust, *Morrissey* and its progeny recognized 5 factors of a business trust: (1) business functions, (2) transferable certificates of beneficial interest, (3) centralized management, (4) continuity of life, and (5) limited liability.<sup>14</sup> While the *Morrissey* test looks to the use of corporate form in the creation of the trust, the decision should not be “pressed so far as to make mere formal procedure a controlling test.”<sup>15</sup>

The Eighth Circuit expanded on the *Morrissey* test, nixing the idea that mere authorization to engage in business is sufficient to transform a pure trust into a business trust.<sup>16</sup> Faced with an organization in which “none of the characteristics of an unincorporated company or association [were] present,” the Eighth Circuit in *Associated Cemetery Management* held that even though the trust was “authorized to, and in fact did engage in business,” the lack of any formal conferral of authority to engage in business and the lack of corporate-like elements were such that the trust was “not transform[ed] ... into a ‘business, moneyed or commercial corporation’ or into a ‘person.’”<sup>17</sup>

In a short opinion, the court in *Cahill* followed the rationale of *Associated Cemetery Management* and held that because the pension trust did not “exhibit the required features” of a corporation, it was not eligible for debtor status and thus barred from obtaining bankruptcy relief.<sup>18</sup> The Eastern District of Pennsylvania there took a formalistic approach to the question of whether a pension trust qualifies for debtor status under the Code.<sup>19</sup>

Although some of the elements of the *Morrissey* test are satisfied, the great weight of the examination lands on refusing to classify a pension trust as a business trust. First, a pension trust has few, if any, “business functions.” The primary purpose of a pension trust is to “preserve the

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<sup>14</sup> See *Medallion Realty Trust*, 103 B.R. at 10 (citing *Morrissey*, 296 U.S. at 359).

<sup>15</sup> 296 U.S. at 358.

<sup>16</sup> See *Associated Cemetery Management, Inc. v. Barnes*, 268 F.2d 97 (8th Cir. 1959).

<sup>17</sup> *Id.* at 103-04.

<sup>18</sup> 14 B.R. at 640; 170 F.Supp. 298.

<sup>19</sup> *Id.*

res” for the beneficiaries of the pension trust, not to carry on business or make a profit.<sup>20</sup> Second, a pension trust does not have transferable certificates of beneficial interest like a corporation would, in fact pension trusts often prohibit the transferability of beneficial interests.<sup>21</sup> While the trust is centrally managed by the trustees, the trustees have the ability to terminate the trust.<sup>22</sup> Lastly, pension trusts generally do limit the liability of the trustees, satisfying the fifth prong of the *Morrissey* test.<sup>23</sup> While some of the formalistic requirements of the *Morrissey* test are met, the lack of business functions is fatal to the classification of a pension trust as a business trust.

#### **B. The substantial business activities test and its applicability to pension trusts**

Another line of cases places less of an emphasis on corporate form, choosing instead to focus on the actual behavior of the trust; namely whether the trust’s operations include substantial business activities, regardless of the formal procedures used to create the trust. For example, in *In re Gonic Realty Trust*, the trustee had “substantial management powers,” and was “subject to very little control by the beneficiaries.”<sup>24</sup> Furthermore, the trustee was “conducting a business operation relating to the leasing of [properties] to commercial and industrial tenants.”<sup>25</sup> Because of the powers and freedom of the trustee, along with the businesslike purpose of the trust, the court in that case determined that the trust was indeed a business trust and therefore eligible for debtor protection.<sup>26</sup> There, the court looked at the relevant factors as “support [for] the evidentiary conclusion that the trust in question was *actually* operating a business in the commonly accepted meaning of such activity” rather than a “definitive list of essential facts to constitute a business trust.”<sup>27</sup>

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<sup>20</sup> See *Catholic School Employees Pension Trust*, 599 B.R. at 642.

<sup>21</sup> *Id.*

<sup>22</sup> *Id.*

<sup>23</sup> *Id.*

<sup>24</sup> See *In re Gonic Realty Trust*, 50 B.R. 710, 710 (Bankr. D.N.H. 1985).

<sup>25</sup> *Id.* at 714.

<sup>26</sup> *Id.*

<sup>27</sup> *Id.* at 713 (emphasis added).

Other courts have similarly emphasized the business purpose of a particular trust, regardless of form. In a traditional trust, the powers granted to the trustee are merely “incidental to the principal purpose of holding and conserving particular property,” while “the powers within a business trust are central to its purpose.”<sup>28</sup> So, the distinction between business trusts and ordinary trusts is that “business trusts are created for the purpose of carrying on some kind of business or commercial activity for profit” while “the object of a nonbusiness trust is to protect and preserve the trust res.”<sup>29</sup> Further, “[i]t is the business trust’s similarity to a corporation that permits it to be a debtor in bankruptcy.”<sup>30</sup> The court in *Treasure Island* refused to treat the lack of formalities as dispositive on the question of whether the land trust was a business trust.<sup>31</sup> Even though the “trust instrument itself reject[ed] any construction of it as a business trust,” the court went on to evaluate the “economic realities of the situation,” and found the debtor “unable to point to any business activity in which it was actively engaged,” and rather found “continuous conduct and assertions to the contrary.”<sup>32</sup> Thus, refusing to extend the definition of “business trust” to include the land trust at issue in *Treasure Island* ultimately turned on an evaluation of the trust’s “objects and purposes.”<sup>33</sup>

Similarly, the Massachusetts Bankruptcy Court proposed in *Medallion* that the simple test should ask just “whether the trust was created to transact business for the benefit of investors.”<sup>34</sup> The court there further held that “Congress intended to permit bankruptcy relief for all trusts which are created for the purpose of transacting business and whose beneficiaries make a contribution . . . to the enterprise, without regard to whether the trust has characteristics of a corporation.”<sup>35</sup>

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<sup>28</sup> *In re Treasure Island Land Trust*, 2 B.R. 332, 334 (M.D. Fla. 1980).

<sup>29</sup> *Id.*

<sup>30</sup> *Id.*

<sup>31</sup> *Id.* at 334-35.

<sup>32</sup> *Id.*

<sup>33</sup> *Id.*

<sup>34</sup> 103 B.R. at 11.

<sup>35</sup> *Id.* at 11-12.

As noted in the cases following *Morrissey*, for a pension trust to be considered a business trust, it must engage in substantial business activities: a pension trust does not. A pension trust is a passive trust that is not engaged in the “active management” of funds and investments for the purpose of increasing profitability.<sup>36</sup> While a pension trust might have a goal of “increas[ing] and maximiz[ing] funds,” this does not affect the overall purpose of the trust, which is to preserve the assets of the trust for the beneficiary.<sup>37</sup> Unlike the trustees in *Gonic Realty*, who had substantial power to transact business and maximize profitability, the trustees of a pension trust are largely limited in their abilities, and instead required to preserve trust funds.<sup>38</sup>

### **C. The *In re Dille Family Trust* analysis and its applicability to pension trusts**

Combining the approaches of the *Morrissey* line of cases and the “substantial business activities” theory, the Western District of Pennsylvania, in *In re Dille Family Trust*, honed in on two crucial questions which, when answered in the affirmative, certify a trust as a business trust.<sup>39</sup> The first question is “whether the trust itself was created for the purpose of transacting a business for a profit,” and the second is “whether the trust in-fact has all of the indicia of a corporate entity.”<sup>40</sup> These two questions distill the formal requirements from the *Morrissey* test, requiring that the trust have been created with a business purpose in mind, and the substantive requirements from the *Gonic* court, requiring that the trust actually function with a business purpose.<sup>41</sup>

Utilizing the two-question test from *In re Dille Family Trust*, pension trusts similarly fail to be classified as business trusts.<sup>42</sup> First, the trust is not created “for the purpose of transacting a business for a profit,” because the purpose of a pension trust – delineated in its governing documents – is

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<sup>36</sup> *Catholic School Employees Pension Trust*, 599 B.R. at 663.

<sup>37</sup> *Id.* at 666.

<sup>38</sup> *Id.* at 665-66.

<sup>39</sup> *In re Dille Family Trust*, 598 B.R. 179 (Bankr. W.D. Pa. 2019).

<sup>40</sup> *Id.* at 194.

<sup>41</sup> *Id.*

<sup>42</sup> 598 B.R. 179.



generally to preserve the *res* for the beneficiaries, not to transact business for a profit.<sup>43</sup> Further, in addressing the formal element of the *In re Dille Family Trust* test, pension trusts do not have the indicia of a corporate entity because neither the governing documents nor the ongoing business of a pension trust display the requisite indicia of a corporate entity to be considered a business trust. Both the intent and purpose of a business trust is substantially different from that of a corporation, and that is reflected in differences between the governing documents.

### CONCLUSION

Since the primary purpose of a pension trust is to “preserve the *res*,” and not to maximize profitability, pension trusts fail the most important element of a business trust. Further supporting the denial of debtor status, pension trusts do not exhibit many of the formalities of a corporation and are instead more in line with an ordinary trust. So, pension trusts are not considered debtors for the purpose of section 109.

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<sup>43</sup> *Id.* at 194; *See Catholic School Employees Pension Trust*, 599 B.R. at 666.