July 29, 2013

Court Finds That a Private Equity Fund is a "Trade or Business" Resulting in Potential Responsibility for Portfolio Company ERISA Liabilities

In a case of first impression at the Circuit Court level, on July 24 the First Circuit released *Sun Capital Partners III, LP, et al.* v. *New England Teamsters & Trucking Industry Pension Fund*, No. 12-2312, 2013 WL 3814984 (1st Cir. July 24, 2013), holding that a private equity fund is a "trade or business" for purposes of ERISA, and therefore may be in the same ERISA "controlled group" as certain of its portfolio companies. The decision is sure to generate controversy, as all members of an ERISA controlled group may be held liable for underfunded single-employer pensions, multiemployer pension plan withdrawal liability, COBRA obligations and certain other ERISA-related liabilities incurred by any member of the controlled group.

Under ERISA, a controlled group generally consists of two or more "trades or businesses" which are under "common control." Historically, private equity funds have taken the position that a fund cannot be a "trade or business" and therefore cannot be a member of a controlled group which includes a portfolio company, irrespective of whether there is sufficient ownership of the portfolio company to meet the "common control" test (most simply, ownership of at least 80% of the vote or value of the portfolio company's equity). In reversing the District Court, the First Circuit agreed with a 2007 PBGC Appeals Board decision which we discussed in our earlier memorandum, finding that a private equity fund may be sufficiently involved in the management and operation of a portfolio company that its activities meet the so-called "investment plus" test, and thereby cause the private equity fund to be a "trade or business" rather than a mere passive investor. The facts cited by the First Circuit which resulted in this finding included (i) repeated statements in the fund's partnership agreement and private placement memorandum that it will be actively involved in the management and operation of its portfolio companies, (ii) the fund's partnership agreement further stating that the general partner of the fund is empowered to make hiring, firing and compensation decisions in respect of portfolio company personnel, (iii) the provision to the portfolio company of employees and consultants of a general partner affiliate for management and consulting services, and (iv) an offset of amounts the fund otherwise would owe the general partner by management fees received from the portfolio company by an affiliate of the general partner.

The *Sun Capital* decision is now back in the hands of the District Court to resolve a number of questions which remain before a definitive determination is made as to whether the private equity fund is actually in the same controlled group as its portfolio company. Even if the First Circuit's conclusion as to the "trade or business" question becomes widely accepted, it still may be possible for private equity funds to avoid becoming a member of their portfolio companies' controlled groups by maintaining ownership under 80% (including splitting ownership among affiliated, but not parallel, funds), or leaving significant portfolio company operating responsibility in the hands of its management. Particularly where a portfolio company maintains or contributes to single employer or multiemployer pension plans, private equity funds should be mindful of *Sun Capital* and either structure investments and operations to minimize the risk of controlled group status, or understand the implications of not doing so.

Michael J. Segal