First Circuit Holds that Private Equity Fund May be Liable for Portfolio Company's Multiemployer Plan Withdrawal Liability

In a decision (*Sun Capital*)[1] with important implications for private equity sponsors, the U.S. Court of Appeals for the First Circuit has concluded that a private equity fund can be held liable for ERISA liabilities incurred by portfolio companies in which the fund has a sufficient stake. While the First Circuit did not determine in this case whether the fund's ownership stake in the portfolio company was sufficient to impose liability, under its decision a fund owning 80% or more of a portfolio company could be liable for the portfolio company's unpaid ERISA Title IV defined benefit pension plan liabilities.

The Sun Capital Decision

Under ERISA, "trades or businesses" under "common control" are aggregated, with each group member jointly and severally liable for ERISA Title IV defined benefit pension plan liabilities incurred by other members.

In *Sun Capital*, which involved multiemployer plan withdrawal liabilities of a bankrupt portfolio company, the First Circuit applied a facts and circumstances analysis to determine whether the fund's management and control over the portfolio company gave rise to a trade or business. While cautioning that no one factor is dispositive, the court concluded that the fund in question was engaged in a trade or business[2] based in part on partnership-agreement and disclosure language referencing active management of portfolio companies, the fund's power to appoint portfolio-company board members (and its appointment of sponsor-related personnel to those positions), and the offset to fund-level fees that would occur if the portfolio company paid for services provided to the portfolio company by fund affiliates – all factors that are common to many private equity arrangements.[3]

"Common control" requires an 80% or greater ownership link, although nominally lower stakes sometimes result in the necessary level of ownership. In *Sun Capital*, ownership was split 70/30 between two funds of the same sponsor. The First Circuit remanded the case to the district court for detailed ownership determinations, but – in a ruling that will be helpful to fund sponsors – it expressly rejected appellant's argument that deliberate structuring of ownership stakes by the two funds could be attacked under an anti-avoidance provision in Section 4212 of ERISA.

Implications

The *Sun Capital* decision highlights the importance of considering ERISA's joint and several liability rules in structuring private equity investments in portfolio companies and in negotiating debt covenants and other agreements related to those investments. Moreover, because "trade or business" status has broad implications for the tax treatment of fund-related activities, the decision can be expected to attract close scrutiny even where ERISA concerns are not present.

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[1] *Sun Capital Partners III LP v. New England Teamsters & Trucking Indus. Pension Fund*, 2013 WL 3814984 (1st Cir. July 24, 2013).

[2] The *Sun Capital* decision gives limited deference to a 2007 PBGC Appeals Board letter that had reached a similar "controlled group" conclusion on other facts.

[3] The court did not adopt appellant's argument that a fund is engaged in a "trade or business" merely by reason of qualifying as a so-called "venture capital operating company" – a designation under ERISA that permits plans to invest in certain collective funds without the assets of the fund itself becoming subject to ERISA fiduciary rules.