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Executive Compensation and Benefits Alert

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Court Ruling Signals Potential ERISA Liability for PE Fund Sponsors

On March 28, 2016, the U.S. District Court for the District of Massachusetts held that three private equity (PE) funds were jointly and severally liable for the multiemployer pension plan withdrawal liability of one of their portfolio companies. The case (opinion available here), on remand from the U.S. Court of Appeals for the First Circuit in a closely watched case, addresses the extent to which a private equity fund and its portfolio company will be treated as a trade or business under common control (and thus jointly and severally liable) for purposes of Title IV of the Employee Retirement Income Security Act of 1974 (ERISA). The ruling of the First Circuit (involving various funds under the Sun Capital Partners, Inc. umbrella) was the subject of a July 29, 2013, client alert.

The district court on remand was charged with determining whether two particular Sun Capital investment funds were engaged in a trade or business based on the "investment plus" standard developed by the First Circuit and whether the three Sun Capital funds that together owned all of the withdrawing employer's parent company were under common control with the withdrawing employer (*i.e.*, whether the funds were under common control with the portfolio company). The district court answered both questions in the affirmative, finding that:

- the funds received an economic benefit in the form of a potential or actual general partner management fee offset (the required investment "plus"); and
- the three funds were a partnership-in-fact that was involved in the active management of the portfolio company with an intent to generate compensation that an ordinary, passive investor would not derive, such that it was likewise a trade or business under the First Circuit standard notwithstanding that there was no direct economic benefit to the partnership-in-fact itself (as opposed to its fund partners).

The district court's application of the First Circuit's new "investment plus" standard is a noteworthy and potentially troubling development for PE sponsors in that the court found not only that the various Sun Capital funds were trades or businesses individually, but also that the funds (none of which themselves had the requisite 80 percent ownership interest in the portfolio company) in operation collectively constituted a partnership-in-fact that was itself a trade or business with a resulting 100 percent portfolio company ownership interest. (The partnership-in-fact finding was despite the lack of partnership formalities.) The court's allusion to "the larger ecosystem of Sun Capital entities" in the course of its analysis suggests a potentially expansive view of the "investment plus" standard, one that could have a significant impact on PE fund operations, particularly if applied beyond the First Circuit.

PE funds with investments in portfolio companies that sponsor plans subject to Title IV of ERISA are urged to consult with counsel about the consequences of this decision.

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