WRMarketplace

An AALU Washington Report

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TOPIC: Surprise, Surprise -- Private Equity Funds Become Joint and Severally Liable for Activities of Portfolio Companies Relative To Their Pension Plans, Despite Preventative Planning.

MARKET TREND: Private equity firms have long structured investments in portfolio companies so that no fund owns 80% or more of the portfolio company to avoid being in "common control" with the portfolio company for various pension plan purposes. A recent court ruling may deem that structure insufficient to avoid withdrawal liability if a portfolio company ceases to make contributions to a multiemployer plan in which it participates.

SYNOPSIS: Two Sun Capital funds (both private equity funds) invested in a portfolio company, although neither owned 80% or more of that company – i.e., the amount that was thought to represent "the test" for common control for multi-employer pension plan purposes. The portfolio company subsequently filed for bankruptcy and incurred multiemployer plan withdrawal liability as a result of its cessation of contributions to the multiemployer plan. The pension fund also assessed the withdrawal liability against the Sun Capital funds, on the basis that the Sun Capital funds were in common control with the portfolio company, and thus joint and severally liable. The District Court of Massachusetts concurred with the pension plan and held that, notwithstanding the less than 80% ownership of the portfolio company by each

fund, the Sun Capital funds were in common control with the portfolio company and thus liable – a very surprising result.

TAKE AWAYS: Based on the Sun Capital case, private equity firms that intentionally and definitively structure a clear partnership between themselves in investing in their portfolio companies may incur pension withdrawal liability if the portfolio companies do not meet their pension obligations, even if none of the funds owns 80% or more of the portfolio company (the threshold previously thought necessary to establish common control). Thus, the less than 80% ownership structure may no longer be the standard for private equity funds to shield themselves from multiemployer plan withdrawal liability. It is unclear from the case, however, whether other pension obligations also would be imposed jointly on the private equity funds.

MAJOR REFERENCES: Sun Capital Partners III, LP, Sun Capital Partners III QP, LP, and Sun Capital Partners IV, LP v. New England Teamsters and Trucking Industry Pension Fund, Civil Action No. 10-10921-DPW, (D.C. Massachusetts, March 28, 2016).

A multiemployer pension plan is typically a plan maintained by a union and contributed to by various employers whose employees are covered by a collective bargaining agreement between the employer and the union. Employers make periodic contributions to the plan to fund the benefits provided to participants and, if an employer ceases to participate in the plan, the employer may be assessed a withdrawal liability to cover the unfunded benefits accrued by its employees. Not only is the withdrawing employer subject to withdrawal liability, but trades or businesses under "common control" with the withdrawing employer are jointly and severally liable for the employer's withdrawal liability.

Typically, common control is found if there is at least 80% common ownership of an entity. Recently, however, the District Court of Massachusetts concluded, in *Sun Capital Partners III, LP, Sun Capital Partners III, QP LP, and Sun Capital Partners IV, LP v. New England Teamsters and Trucking Industry Pension Fund* (the "Sun Capital Case"), that two private equity firms were in common control of a portfolio company even though this 80% common ownership standard was not met. The problem, however, is that private equity firms have long used this structure for maintaining their portfolios of investment companies.

CASE BACKGROUND

In 2006, two private equity funds sponsored by Sun Capital Advisor Inc., Sun Capital Partners III, LP and Sun Capital Partners IV, LP, effectively acquired a 30% and 70% interest, respectively, in Scott Brass, Inc. ("**SBI**"). The acquisitions were made through an intermediary entity, Sun Scott Brass, LLC.

Sun Capital Partners III, LP and Sun Capital Partners IV, LP (collectively, the "**Sun Funds**") had different general partners but had limited partner committees comprising the same individuals, who also were the co-CEOs of Sun Capital Advisors Inc. In addition, Sun Capital Advisors, Inc. advised the Sun Funds, structured their deals, and provided management consulting to the portfolio companies they owned.

In 2008, SBI filed for bankruptcy and was assessed over $4.5 million in withdrawal liability by the New England Teamsters and Trucking Industry Pension Fund, which also asserted that the Sun Funds were jointly and severally liable for this liability because they were a trade or business under common control with SBI. This common control question became a key issue for the District Court to resolve.

DECISION HIGHLIGHTS – WHAT WE LEARN ABOUT COMMON CONTROL

At its core, the District Court had to find some type of business agreement between the Sun Funds that owned SBI to establish common control.

Thus, while neither of the Sun Funds owned more than 80% of SBI and no formal partnership existed between the Sun Funds with regard to their aggregate ownership of SBI, the District Court still concluded that there existed a ***partnership-in-fact*** or some sort of ***joint venture*** to own SBI in its entirety, based on the following:

- The District Court cited the U.S. Supreme Court for the factors for determining whether a partnership was created: "A partnership is generally said to be created when persons join together their money, goods, labor, or skill for the purpose of carrying on a trade, profession, or business and when there is community of interest in the profits and losses….[T]he question arises whether the partners really and truly intended to join together for the purpose of carrying on business and sharing in the profits or losses or both."

- The District Court noted that the Sun Funds were "closely affiliated entities and part of the larger ecosystem of Sun Capital entities created and directed by Marc Leder and Roger Krouse…. Leder and Krouse, acting as the limited partner committees of the general partners of each Fund, retain substantial control over both Funds….

The Funds have identical language in their partnership agreements and are operated similarly."

- Despite noting various factors that argued against there being a partnership-in-fact between the Sun Funds, the District Court found that "a more limited partnership or joint venture, however, is to be found, based on the present record. The Sun Funds are not passive investors in Sun Scott Brass, LLC [the intermediary entity] brought together by happenstance, or coincidence." Rather, the Funds took specific, intentional steps to "partner," such as creating Sun Scott Brass, LLC to invest in SBI. Moreover, between 2005 and 2008, the Sun Funds similarly co-invested in five other companies, using the same organizational structure. More importantly, before formation and purchase, joint activity took place for the Sun Funds to decide to co-invest, and the District Court concluded that "that activity was plainly intended to create a partnership-in-fact."

- Perhaps most significantly, the District Court stated that "[n]otably, the Funds made a conscious decision to split the ownership stake 70/30 for reasons that demonstrate the existence of a partnership. The Funds assert three motivations for this split: that Sun Fund III was nearing the end of its investment cycle while Sun Fund IV was earlier in its own cycle, a preference for income diversification, and a desire to keep each Fund below 80% ownership to avoid withdrawal liability."

  The District Court noted that income diversification was an objective that two truly independent entities could pursue, but that "***the 70/30 split does not stem from two independent funds choosing, each for its own reasons, to invest at a certain level. Rather, these goals stem from top-down decisions to allocate responsibilities jointly****…. **[Similarly,] the choice to organize Sun Scott Brass, LLC, so as to permit each of the Sun Funds co-investing to remain under 80% ownership, is likewise a choice that shows an identity of interest and unity of decision making between the Funds rather than independence and mere incidental contractual coordination***. A separate entity which is perhaps best described as a partnership-in-fact chose to establish this ownership structure and did so to benefit the plaintiff Sun Funds jointly. (Emphasis added.)" It was this partnership-in-fact that owned 100% of SBI, and the attributes of complete ownership flowed to the Sun Funds as the partners in this partnership-in-fact.

TAKE AWAYS

Based on the Sun Capital case, private equity firms that intentionally and definitively structure a clear partnership between themselves in investing in their portfolio

companies may incur pension withdrawal liability if the portfolio companies do not meet their pension obligations, even if none of the funds owns 80% or more of the portfolio company (the threshold previously thought necessary to establish common control). Thus, the less than 80% ownership structure may no longer be the standard for private equity funds to shield themselves from multiemployer plan withdrawal liability. It is unclear from the case, however, whether other pension obligations also would be imposed jointly on the private equity funds.

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