

Private Equity: Investment Plus? The Sun Capital Case

Are "value-added investors" risking pension plan withdrawal liability?

On July 24, 2013, the U.S. Court of Appeals, First Circuit, issued its opinion in *Sun Capital Partners III, L.P. v. New England Teamsters & Trucking Industry Pension Fund*.

The case arose out of the bankruptcy of Scott Brass, Inc. (SBI), a Sun Capital portfolio company held by two separate limited partnerships (the Sun Capital Funds). SBI was a contributing employer to the defendant multi-employer defined benefits pension plan (the Pension Fund). After the bankruptcy filing, SBI stopped making payments to the Pension Fund. The Pension Fund sent Sun Capital a demand for payment of SBI's estimated withdrawal liability of approximately \$4.5 million. Sun Capital filed a declaratory judgment action in federal district court in Massachusetts, seeking a ruling that the Sun Capital Funds were not subject to withdrawal liability because (1) they and SBI were not under common control, and (2) the Sun Capital Funds were not a trade or business.

The district court never addressed the "common control" issue, having determined that the Sun Capital Funds did not constitute a "trade or business." The Pension Fund appealed to the First Circuit.

The First Circuit reversed, applying a fact intensive analysis to determine, under a test the court described as "investment plus," that the Sun Capital Funds were a trade or business. As a result, not only Sun Capital but each of its 80% or more controlled portfolio companies may be jointly liable for the claimed withdrawal liability. To some degree, all of the factors cited by the court are common to private equity funds:

- The Sun Capital Funds invested to make a profit.
- The offering memo for each of the Sun Capital Funds stated that the fund's general partner would manage and supervise its investments.
- Before acquiring a portfolio company, Sun Capital developed restructuring and operating plans to be implemented during a post-closing transition period.
- Sun Capital appointees comprised a majority of the SBI board of directors.
- A Sun Capital entity provided services to SBI in exchange for a management fee, and the management fee was credited against the fees the Sun Capital Funds' limited partners would otherwise be charged (so the Sun Capital Funds

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indirectly received service fees, not just investment returns).

While private equity investors are unlikely to modify their approach to "value added investing" in response to this case, they will need to take a much harder look at companies with multi-employer pension plans or underfunded pension obligations.

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