

# Pension Pitfalls

MIDMARKET TRENDS // Sun Capital Case Underscores Importance of Pension Review



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**O**n March 28, the District Court of Massachusetts issued a highly anticipated decision in Sun Capital Partners III LP v. New England Teamsters & Trucking Industry Pension Fund. On remand, the federal court determined that private equity funds had formed a partnership-in-fact, were engaged in a trade or business that was part of a controlled group and, as a result, were jointly and severally liable for the pension plan withdrawal liability obligations of their portfolio company, Scott Brass, Inc.

The court found that the economic benefits Sun Capital Partners III L.P. (Fund III) and Sun Capital Partners IV LP (Fund IV) received, including from management fee offsets and management fee offset carryforwards, were over and above the return that an ordinary passive investor would expect to receive. When combined with the funds' active involvement in the management of Scott Brass operations, the court found that the funds were each engaged in trade or business for purposes of the Multiemployer Pension Plan Amendments Act of 1980.

In addition, the court determined that the funds had formed a partnership-in-fact; looking at, among other things, the facts that the funds created a holding company in order to invest in the portfolio company, that they engaged in joint activities prior to the acquisition of the portfolio company to determine whether to co-invest in it, and that they previously co-invested in five other portfolio companies. In determining that a partnership-in-fact existed, the court held that the de facto partnership was itself a trade or business. Even though neither fund held 80 percent of the portfolio company, the de facto partnership was under "common control" with the portfolio company within the meaning of the Employee Retirement Income Security Act of 1974. As a result, the court determined that this

partnership and consequently its partners (the funds) were jointly and severally liable for the portfolio company's pension plan withdrawal liability obligations.

Although still subject to appeal, the Sun Capital case highlights the need for a thorough examination of a target company's pension plan and possible withdrawal liabilities. In addition, private equity funds should consider carefully how they structure co-investments, especially by related funds with overlapping management.

It is also important to note that in its analysis of whether or not the funds or the de facto partnership were engaged in trade or business or under common control with Scott Brass, the court looked to federal income tax principals for guidance. It is therefore possible that the determinations in Sun Capital could be used to bring actions against funds for other portfolio company obligations, including tax liabilities. //

**Jane A. Meyer** primarily focuses on representing private equity and SBIC funds in the negotiation and drafting of senior, mezzanine and equity financing documents, as well as joint venture, acquisition and disposition agreements.

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