

Another Look at Sun Capital: PE Fund Faces Claims for Unfunded Pension Liability of a Portfolio Company

The Bottom Line

- *While the court has not yet reached a decision on Trilantic's complaint, PE firms should continue to carefully consider the structure and nature of their portfolio company investments to assess any potential exposure for pension withdrawal liability.*
- *In this post-Sun Capital time, PE firms are advised to closely analyze potential employee benefits liability of portfolio companies and consider the management activities that may land them in "investment-plus" territory, specifically when it comes to potentially shared pension liabilities.*
- *Indeed, the Trilantic case serves as a reminder to PE firms that they could end up on the hook — or at least involved in a claim — for pension-related liabilities of one of their portfolio companies.*

Private equity (PE) funds are revisiting the 2016 decision by the U.S. District Court of Massachusetts in *Sun Capital Partners III, LP v. New England Teamsters & Trucking Indus. Pension Fund (Sun Capital)*, which applied an "investment plus" approach to find a PE fund liable for pension plan withdrawal liability of a portfolio company. This time, a recent complaint indicates that PE funds continue to be at risk for such claims by multiemployer plans and the Pension Benefit Guaranty Corporation (PBGC) that they are liable for unfunded pension liability of a portfolio company.

On September 29, 2017, Trilantic Capital Partners (Trilantic) filed a complaint in the Southern District of New York seeking a declaratory judgment that they are not jointly and severally liable for withdrawal liability of their portfolio company, Angelica Corporation (Angelica), citing that Trilantic is not part of a "trade or business" under "common control" as set forth in the Employee Retirement Income Security Act of 1974, as amended (ERISA).

Revisiting *Sun Capital*

Under ERISA, each member of a "controlled group" is jointly and severally liable for certain defined benefit pension plan liabilities, including withdrawal liability that arises when a plan sponsor terminates contributions to a plan. In general, a "controlled group" is defined as two or more "trades or businesses" under "common control." However, the definition of "trades or businesses" is not clearly defined in the law and has been left to the courts to determine. Historically, investment funds were not found to qualify as "trades or businesses." In the case of a PE fund, the fund's investment activities often amount to more than those of a passive investor and have thus raised a question of whether the fund is involved in a trade or business.

The U.S. District Court of Massachusetts, in reliance on guidance from the First Circuit, addressed this question in *Sun Capital*. The *Sun Capital* decision applied an "investment-plus" test and found that the sum of the PE fund's investment plus its other activities amounted to a greater role than would be played by a passive investor. On that basis, the court concluded that the fund was engaged in a trade or business.

In addition to being classified as a trade or business, the entities must be under “common control” to be held jointly and severally liable for unfunded pension obligations. The “controlled group” rules ordinarily require a controlling interest of at least 80% ownership. The decision in *Sun Capital* found that two separate funds constituted a “partnership-in-fact” by virtue of their co-investment in a portfolio company. Neither fund alone met the 80% threshold but the ownership of the funds was aggregated and the District Court found that the funds were jointly and severally liable for the portfolio company’s pension withdrawal liability.

Trilantic Capital Partners

In 2008, Trilantic IV, a fund managed by Trilantic, purchased a majority of the equity of Angelica, a company providing medical laundry and linen management services. Angelica had close to 4,000 employees and participated in several multiemployer pension funds and one single-employer pension plan. In recent years, Angelica’s business struggled due in large part to changes in the healthcare industry (according to the complaint filed by Trilantic). In August 2017, Angelica filed for bankruptcy and stopped contributing to its multiemployer pension plans. The bankruptcy proceeding triggered a “complete withdrawal” by Angelica and resulted in the pension funds and the PBGC asserting withdrawal and termination liability against Trilantic IV, as a member of Angelica’s controlled group.

Question of Trade or Business

Similar to the argument raised by the Sun Capital funds in *Sun Capital*, Trilantic claims it is not subject to controlled group liability with Angelica because it is not a “trade or business.” The complaint by Trilantic contends that *Sun Capital* was wrongly decided and seeks to distinguish Trilantic’s investment activities from those of Sun Capital and thereby argue that the “investment-plus” standard is not met. Specifically, Trilantic highlighted that it was not involved in the operation or management of Angelica and it did not receive any type of management or monitoring fees or fee offsets from Angelica. On the other hand, however, Trilantic did concede that it appointed members of Angelica’s board and that it is involved in management and day-to-day operations on an interim or emergency basis, as when there is a leadership turnover.

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