NOTES

WHERE DO WE GO NOW? THE UNCERTAIN FUTURE FOR 29 U.S.C. § 1301(b)(1), PRIVATE EQUITY FUNDS, AND MULTIEMPLOYER PENSION PLANS AFTER *SUN CAPITAL*

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I. INTRODUCTION

As the recent Hostess Brands bankruptcy revealed, our nation faces a growing problem of corporate indebtedness to pension plans—specifically, multiemployer pension plans (MEPPs).[1] MEPPs are collectively bargained benefits plans in which a number of employers, usually those within the same industry, contribute to a fund benefitting all the participating companies' employees.[2] MEPPs appeal to employers because they enable them to offer competitive pension benefits with less risk due to group risk-sharing.[3] Employees also benefit from MEPPs because they enable workers to move to another company participating in the same plan without worrying about their benefits carrying over to their new job.[4] An employer that ceases to contribute to its MEPP faces a withdrawal penalty—its share of the plan's vested but unfunded benefits.[5]

A recent decision by the First Circuit in *Sun Capital Partners III, L.P. v. New England Teamsters & Trucking Industry Pension Fund*[6] has the potential to impact MEPPs' long-term viability and to unsettle another entity also receiving recent national attention, private equity funds. Briefly, a private equity fund is a limited partnership investment vehicle in which investors such as university endowments, charitable foundations, and public and private retirement plans—these investors are called limited partners—commit capital that will be managed by the fund's general partner, an entity usually headed by the principals of the

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[1] *See* Emily Chasan, *Multi-Employer Pension Plans Strained Hostess*, WALL ST. J., CFO J. (Jan. 11, 2012, 12:12 PM), http://blogs.wsj.com/cfo/2012/01/11/multiemployer-pension-plans-strained-hostess/ (stating that Hostess entered bankruptcy largely to restructure its MEPPs liabilities).

[2] Paul M. Secunda, *The Forgotten Employee Benefit Crisis: Multiemployer Benefit Plans on the Brink*, 21 CORNELL J.L. & PUB. POL'Y 77, 83 (2011).

[3] *See* Concrete Pipe & Prods. of Cal., Inc. v. Constr. Laborers Pension Trust for S. Cal., 508 U.S. 602, 606 (1993) (explaining why MEPPs are advantageous for both employers and employees).

[4] *See* Chasan, *supra* note 1 (identifying the key benefit MEPPs afford employees).

[5] *See* 29 U.S.C. §§ 1381, 1391 (2012) (defining employer withdrawal from a MEPP and explaining how the withdrawal liability amount is computed, respectively); *see also Concrete Pipe & Prods.*, 508 U.S. at 607–09 (explaining the withdrawal liability statute and how the courts ought to apply it).

[6] 724 F.3d 129 (1st Cir. 2013).

private equity firm that raised the fund.[7] This capital is typically invested into businesses to which the firm's professionals provide management and advisory services in hopes of improving these companies' performance.[8] If these services lead to the businesses' successful growth, the investors will earn a profit when the fund exits the investment by either selling its ownership stake or taking the company public.[9]

In *Sun Capital*, the First Circuit held that the private equity fund Sun Capital Partners IV (Sun Fund IV) of the firm Sun Capital Advisors, Inc. is a "trade or business" under 29 U.S.C. § 1301(b)(1),[10] a provision of the Employee Retirement Income Security Act (ERISA).[11] ERISA, passed in 1974, is a comprehensive federal reform package regulating employer-provided benefits plans.[12] As a "trade or business," Sun Fund IV (if it satisfies other statutory requirements, as determined on remand)[13] can be held jointly and severally liable for its portfolio

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[7] *See* Steven N. Kaplan & Antoinette Schoar, *Private Equity Performance: Returns, Persistence, and Capital Flows*, 60 J. FIN. 1791, 1793 (2005) (providing an introduction to private equity funds' structure).

[8] *See* Bronwyn Bailey, *Long-Term Commitments: The Interdependence of Pension Security and Private Equity*, THE PRIVATE EQUITY GROWTH CAPITAL COUNCIL 2 (Apr. 8, 2013), http://www.pegcc.org/wordpress/wp-content/uploads/Long-Term-Commitments-The-Interdependence-of-Pension-Security-and-Private-Equity.pdf (explaining most private equity funds' basic investment strategy).

[9] *See id.* at 1 (identifying common private equity investment exit strategies).

[10] The full text of § 1301(b)(1) reads:

> An individual who owns the entire interest in an unincorporated trade or business is treated as his own employer, and a partnership is treated as the employer of each partner who is an employee within the meaning of section 401(c)(1) of Title 26. For purposes of this subchapter, under regulations prescribed by the corporation, all employees of trades or businesses (whether or not incorporated) which are under common control shall be treated as employed by a single employer and all such trades and businesses as a single employer. The regulations prescribed under the preceding sentence shall be consistent and coextensive with regulations prescribed for similar purposes by the Secretary of the Treasury under section 414(c) of Title 26.

[11] Employee Retirement Income Security Act of 1974, 29 U.S.C. §§ 1001–1461 (2012).

[12] *See* Secunda, *supra* note 2, at 82 (describing the motivations behind enacting ERISA).

[13] For an entity to be held jointly and severally liable for another entity's withdrawal liability to a benefits plan under § 1301(b)(1), the entity must be engaged in a trade or business and be in the same "common control group" as the withdrawing employer. *Id.* If these two prongs are satisfied, the entity will be deemed a "single employer" along with the actual contributing employer and will likewise be liable for the withdrawal payment. *Id.* The First Circuit has ordered the district court to determine on remand whether Sun Fund

company's MEPP withdrawal liability.[14] This decision, over the long term, could negatively affect the private equity industry, MEPPs, and their employee beneficiaries.

At first blush, it may seem odd to claim that two such dissimilar entities as a union pension plan and a private equity fund share a commonality of interest in this case. After all, as evidenced by the Occupy Wall Street movement and the rhetoric surrounding the 2012 presidential election, social politics have transformed the Wall Street fund manager and the Teamster into the diametric archetypes of America's latest great culture war—what to do about the vast income disparities between the so-called "one-percenters" and everyone else.[15] However, the worlds these figures represent are in fact closely entwined. From 2001–2011, pensions were private equity funds' largest category of investor, providing roughly 43% of these funds' invested capital.[16] Private equity returns the favor, generating twice the investment returns for pensions than their investments in the public equity markets.[17] Given the close relationship between private equity funds and pensions, *Sun Capital* is uniquely positioned to reach across the American socioeconomic gradient and generate serious problems for both union members as MEPP beneficiaries and private equity fund managers.

This Note will explore *Sun Capital*'s flawed analysis and suggest the policy ramifications for both the private equity industry and MEPPs it might engender. Part II will begin by providing background information on the basic structure of private equity funds and transactions. It will also explore MEPPs and the

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IV was under common control group with the company it acquired that incurred the withdrawal liability. Sun Capital Partners III, LP v. New Eng. Teamsters & Trucking Indus. Pension Fund, 724 F.3d 129, 148–49 (1st Cir. 2013).

[14] *See supra* note 13 and accompanying text (explaining the statutory requirements to be held liable under the statute for another entity's withdrawal liability); *see also* Cent. States, Se. & Sw. Areas Pension Fund v. Fulkerson, 238 F.3d 891, 894–95 (7th Cir. 2001) (discussing that § 1301(b)(1) is not intended to hold all employers contributing to pensions liable for withdrawal payments, only those owning entities classified as trades or businesses).

[15] *See, e.g.*, Christopher Ketcham, *The Reign of the One Percenters: Income Inequity and the Death of Culture in New York City*, ORION MAG. (Nov./Dec. 2011), http://www.orionmagazine.org/index.php/articles/article/6470 (criticizing the high finance industry for contributing to, among other things, New York's status as the city with America's greatest income inequality).

[16] Bailey, *supra* note 8, at 3.

[17] *Id.* at 5.

laws and actors that govern them. Specifically, it will address how withdrawal liabilities are assessed, particularly when, as in *Sun Capital*, the withdrawing employer files for bankruptcy. Establishing a working knowledge of private equity funds and MEPPs will be beneficial when examining *Sun Capital*'s treatment of these entities. Part II will offer an overview of *Sun Capital* itself by summarizing the case's factual background and parsing the district court and First Circuit's reasoning.

Part III will begin by arguing that the First Circuit erroneously and unjustifiably departed from past interpretations of § 1301(b)(1) when it deemed Sun Fund IV a trade or business. *Sun Capital* is the first time an ERISA-only definition of trade or business has been established.[18] The statute clearly indicates that its terms—including trade or business—must be interpreted according to § 414(c) of the Tax Code.[19] Therefore, the First Circuit's classification of Sun Fund IV as a trade or business solely for the purposes of § 1301(b)(1) appears erroneous. Part III will also compare the First Circuit's reasoning to those in a series of Supreme Court tax cases generally recognized as providing the appropriate judicial test for whether an activity constitutes a trade or business, used in both ERISA and tax contexts. Doing so will reveal that the First Circuit's new proposed test contravenes this precedent and promises to create confusion into a previously settled, although perhaps underdeveloped, area of law.

Part IV will explore how *Sun Capital* might cause tricky issues for private equity funds and their managers and only hasten MEPPs' demise going forward. In its analysis, the First Circuit seized on several common private equity practices in reaching its conclusion that Sun Fund IV was a trade or business.[20] *Sun Capital* therefore places private equity managers in a difficult

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[18] *See* Misha Ross, *The Intersection of Private Equity and ERISA after* Sun Capital, MICH. J. PRIVATE EQUITY & VENTURE CAPITAL L. ONLINE (Apr. 20, 2014), http://MJPVL.org/the-intersection-of-private-equity-and-erisa-after-sun-capital/ (noting that "the decision was the first instance in which a court has treated a private equity fund as a 'trade or business' under ERISA").

[19] *See* 29 U.S.C. § 1301(b)(1) (2012) ("The regulations prescribed under the preceding sentence shall be consistent and coextensive with regulations prescribed for similar purposes by the Secretary of the Treasury under section 414(c) of Title 26.").

[20] Sun Capital Partners III, LP v. New Eng. Teamsters & Trucking Indus. Pension Fund, 724 F.3d 129, 141–42 (1st Cir. 2013).

position, as they may have to modify or eliminate certain core business practices to avoid resembling Sun Fund IV and having their funds deemed trades or businesses. Regarding MEPPs, though the First Circuit seemingly gave a boon to the MEPP at issue by holding that it might be able to pursue Sun Fund IV's deep pockets for the withdrawal liability, the decision may ultimately harm MEPPs in the long term. After *Sun Capital*, private equity funds now face a heightened risk for incurring their portfolio companies' MEPP withdrawal liabilities, and consequently, fund managers may hesitate to acquire troubled companies contributing to underfunded MEPPs.[21] Without infusions of private equity investments, these troubled companies may become failed companies, further straining these MEPPs and the other companies that participate in them. The First Circuit has seemingly overlooked that disincentivizing the private sector from "assum[ing] control of failing companies and their pension plans" contravenes congressional intent.[22]

Finally, Part V briefly concludes by offering some final perspectives on what a post-*Sun Capital* future might entail for private equity funds, MEPPs, and their beneficiaries.

II. BACKGROUND

A. THE BASICS OF PRIVATE EQUITY

Attaining a clear understanding of *Sun Capital* necessitates first exploring private equity's basic structures and operations. To begin, private equity firms, usually called sponsors,[23] are typically

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[21] *See* Brief of the Private Equity Growth Capital Council as Amicus Curiae Supporting Appellees' Petition for Panel Rehearing or Rehearing En Banc at 5, Sun Capital Partners III, LP v. New Eng. Teamsters & Trucking Indus. Pension Fund, 724 F.3d 129 (1st Cir. 2013) (No. 10-CV-10921) [hereinafter Brief of the Private Equity Growth Capital Council] (arguing that the increased risk of incurring withdrawal liabilities will dissuade private equity from investing in companies contributing to large or unfunded pensions).

[22] *See* Appellees' Response Brief at 55–56, Sun Capital Partners III, LP v. New Eng. Teamsters & Trucking Indus. Pension Fund, 724 F.3d 129 (1st Cir. 2013) (No. 10-CV-10921) (quoting *In re* Challenge Stamping & Porcelain Co., 719 F.2d 146, 150 (6th Cir. 1983)) (explaining that Congress enacted ERISA in part to foster responsible private sector control of pension plans).

[23] *See* Scott W. Naidech, *Private Equity Fund Formation*, THE PRACTICAL LAW COMPANY 1 (Nov. 2011), http://www.chadbourne.com/files/Publication/3d5a9a56-734c-4d30-a5e4-0a8c5939 67ab/Presentation/PublicationAttachment/12cdc9fc-964d-4b0e-a0d4-c48ce9dd7c2f/Naidech_Pr

organized as private limited partnerships.[24] These firms are essentially investment entities formed by sophisticated investors and businesspeople that use their business acumen to raise capital and manage investments in target companies whose performance they hope to improve.[25] Private equity firms can engage in several basic types of transactions; however, these transactions have two commonalities: their capital has been privately raised and will not be invested in publicly traded securities.[26] They include investments in start-up companies, known as "venture capital"; investments in mature, yet still private companies, called "growth stage" investments; leveraged buyouts, the infamous "LBOs" featured in *Barbarians at the Gate*,[27] in which the firms acquire a division of or a whole, usually public, company to later sell it or take it public again; and distressed debt investments in which firms invest in financially struggling companies at a steep discount, termed "vulture" investments.[28]

Private equity firms do not invest their capital directly. Rather, they establish funds, usually as limited partnerships or, occasionally, limited liability corporations, to pool the investors' capital and to finance transactions.[29] Private equity funds are closed-end funds, meaning their formation agreements define a fixed time period during which their sponsors can solicit

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ivateEquityFundFormation_Nov11.pdf (noting that private equity firms and their principals are called sponsors in industry parlance).

[24] *See* Brian Cheffins & John Armour, *The Eclipse of Private Equity*, 33 DEL. J. CORP. L. 1, 9 (2008) (stating that most private equity firms are organized as private partnerships). Recently, some of the largest private equity firms, including Blackstone, have undergone public offerings and are now publically traded. They are in the minority, however. *Id.*

[25] *See* William A. Birdthistle & M. Todd Henderson, *One Hat Too Many? Investment Desegregation in Private Equity*, 76 U. CHI. L. REV. 45, 49–50 (2009) (describing the essence of a private equity fund).

[26] *See* Cheffins & Armour, *supra* note 24, at 8 (explaining the universal features of private equity transactions).

[27] *See generally* BRYAN BURROUGH & JOHN HELYAR, BARBARIANS AT THE GATE: THE FALL OF RJR NABISCO (1990) (providing an in-depth examination of the private equity firm Kohlberg, Kravis Roberts & Co.'s leveraged buyout of RJR Nabisco and the LBO process). This fantastic book is highly recommended to those interested in private equity and financial history.

[28] *See, e.g.*, Naidech, *supra* note 23, at 1 (discussing various private equity investments).

[29] *See* Cheffins & Armour, *supra* note 24, at 9 (explaining that private equity firms establish funds to raise the capital and purchase the stakes in the target companies).

investors.[30] After this period elapses, the fund cannot take on more investors.[31] Though the timelines may vary, these funds then have about a ten-year window in which to invest the capital, manage and subsequently exit the investments, and liquidate the fund and distribute profits to the partners.[32] Savvy fund sponsors often contribute some of their own capital into their funds.[33] Potential investors like sponsors to contribute their own money because it makes the investors feel as though the sponsors' interests are better aligned with their own.[34] Until recently, private funds could avoid registering with the U.S. Securities & Exchange Commission due to certain exemptions in the Investment Advisors Act of 1940.[35] However, the Dodd-Frank Wall Street Reform and Consumer Protection Act, passed in 2010 to restructure the federal financial regulatory scheme, eliminated or greatly narrowed many of these exemptions.[36]

As mentioned in Part I, private equity investors are principally large institutional investors who serve as the funds' limited partners.[37] These limited partners are shielded by limited liability[38] but cannot participate in the fund's management decisions or vote out the general partners.[39] Because private equity funds are sophisticated investment vehicles engaging in

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[30] *See* Naidech, *supra* note 23, at 4 (explaining the core features of a closed-end fund, specifically that the time frame for raising investments is usually between twelve and eighteen months).

[31] *Id.*

[32] *See* Scott W. Naidech, *Timeline of a Private Equity Fund*, THE PRACTICAL LAW COMPANY, http://us.practicallaw.com/9-509-3018?q=naidech (last visited Aug. 11, 2013) (diagraming and explaining a private equity fund's typical lifetime).

[33] Naidech, *supra* note 23, at 4–5.

[34] *See id.* (describing why sponsors contribute their own capital to their funds).

[35] *See Summary of the Dodd-Frank Act: Private Equity & Hedge Funds*, THE PRACTICAL LAW COMPANY, http://us.practicallaw.com/1-502-8932?q=summary+of+Dodd-frank:+private+equity (last visited Aug. 11, 2013) (discussing various registration exemptions private funds enjoyed prior to the recent reforms, most notably the private investment advisor exemption, covering funds managed by professionals overseeing less than fifteen funds who did not publicly represent themselves as investment advisors).

[36] *See id.* (stating the intent of the Dodd-Frank Act).

[37] *See supra* note 7 and accompanying text.

[38] Limited partners' limited liability is similar to that of corporate shareholders, in that they cannot be held liable for the partnership's debts. *See* Naidech, *supra* note 23, at 2 (explaining limited partners' liabilities). Their liabilities are usually capped at the extent of their investments and share of the profits, subject to certain, albeit rare, exemptions. *Id.*

[39] *See* Cheffins & Armour, *supra* note 24, at 9 (identifying the benefits and limitations of serving as a limited partner).

risky, complex transactions, sponsors usually set a high minimum investment threshold, often in the $5 to $10 million range.[40] Usually, investors do not contribute all their capital upfront; instead, they pay in installments on an as-needed basis throughout the fund's life to finance an acquisition or pay various fees and expenses.[41] Another defining characteristic of private equity funds, one potentially posing an issue for the limited partners, is the "lock-in" of their capital to the fund for its duration.[42] This provision gives investors virtually no rights to withdraw their capital or to withhold a contribution to the fund when the sponsor makes a capital call, no matter what more urgent matters may necessitate their money.[43] From the sponsor's perspective, however, lock-in provisions are much needed; turning around portfolio companies is a medium-to-long-range endeavor, and sponsors need the security of knowing capital will be available to finance these operations when needed.[44]

Private equity funds' general partners are entities typically headed by the principals of the firm that raised the fund.[45] For most funds, the general partner is a special purpose entity—either itself a limited partnership or limited liability company[46]—created to shield the sponsors, since, under limited partnership law, the general partner is liable for claims against the partnership.[47] General partners are compensated by an annual management fee, typically a fixed percentage of assets under management—the industry norm is 2%—and a defined share of the fund's profits,

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[40] *Id*. at 11.

[41] *See* Naidech, *supra* note 23, at 2 (explaining how a fund's limited partners typically contribute their investment into the fund over time).

[42] Birdthistle & Henderson, *supra* note 25, at 53.

[43] *See* Ronald W. Masulis & Randall S. Thomas, *Does Private Equity Create Wealth? The Effects of Private Equity and Derivatives on Corporate Governance*, 76 U. CHI. L. REV. 219, 222 (2009) (stating that lock-in provisions give limited partners little to no withdrawal rights during the fund's life).

[44] *See* Birdthistle & Henderson, *supra* note 25, at 53 (explaining how the nature of private equity calls for lock-in provisions).

[45] *See* Kaplan & Schoar, *supra* note 7, at 1793 (identifying the main parties in a private equity fund).

[46] Victor Fleischer, *Two and Twenty: Taxing Partnership Profits in Private Equity Funds*, 83 N.Y.U. L. REV. 1, 9 (2008).

[47] *See* Naidech, *supra* note 23, at 3 (describing why sponsors structure the general partner as a separate entity apart from the firm itself).

commonly called carried interest.[48] Private equity managers and their affiliated entities' fees present complex and controversial issues.

One fee-related issue, known as the management fee offset, features prominently in *Sun Capital*. In connection with forming a fund, the sponsor typically creates a separate entity to serve as a management company.[49] The management company will then contract with the general partner to act as the fund's investment advisor and manager.[50] Under this agreement, the fund will pay the management company fees and, in exchange, the management company agreement will employ investment professionals, evaluate investment opportunities for the fund, and provide various investment advisory services.[51] Additionally, the management company will also enter into agreements directly with the fund's portfolio companies.[52] Pursuant to these contracts, the management company is often the entity providing the professionals to assist the portfolio companies in improving their performance.[53] Because these separate agreements create two sources of fees for management companies, a fund's formation documents will often contain an offset mechanism of a dollar-for-dollar reduction from the fee the fund owes the management company, calculated as a defined percentage of fees the management entity receives from the portfolio companies.[54] For example, assume a fund's formation documents provide that the fund will receive a dollar-for-dollar offset of 60% of any fees the management company receives directly from the portfolio companies. If the portfolio companies paid $6 million in fees to the

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[48] *See, e.g.*, Fleischer, *supra* note 46, at 8 (providing a basic overview of general partners' compensation). General partners typically receive 20% of the funds' profits. *Id.* The title of Fleischer's article references the common industry term for general partners' compensation, the so-called "two and twenty" model. *Id.* at 3.

[49] Naidech, *supra* note 23, at 8.

[50] *Id.*

[51] *See id.* (describing the typical terms of investment advisory agreements entered into by fund sponsors or their general partners, or both, and the management companies that assist them).

[52] *Id.*

[53] *See id.* at 9 (noting that entities affiliated with funds' general partners often provide management and advisory services to portfolio companies).

[54] *See id.* (describing the common practice of funds receiving an offset from the fees it owes the management companies if they also receive fees directly from the fund's portfolio companies).

management company, the fund could discount 60%, or $3.6 million, from the fees it owed. This may pose problems for the limited partners, however, as the financial gains attributable to the offset may be characterized as ordinary income for federal tax purposes rather than investment income, which receive more favorable treatment.[55]

B. BACKGROUND ON MEPPS AND WITHDRAWAL LIABILITY

Getting to the heart of *Sun Capital* also requires understanding MEPPs and the laws and actors that govern them. The Taft-Hartley Act of 1947 marked the first time MEPPs received major treatment in federal law and outlined the basic requirements to which they must adhere.[56] Section 302(c)(5) of the Taft-Hartley Act makes it illegal for employers to provide and for union leaders to accept money or anything else of value; however, § 302(c)(5) also exempts MEPPs from this prohibition if they satisfy five criteria: (1) the participating employers' payments must be held in a trust; (2) the employers' contribution obligations are outlined in a written agreement; (3) the union and the employers have an equal say in the trust's administration; (4) the trust undergoes an annual audit; and (5) the trust is segregated from other funds and used exclusively for pension payments.[57] World War II spurred a rise in private pension plans, including MEPPs, as government-mandated wage and price controls forced employers to seek alternative means of compensating workers.[58] Private pension plans remained popular after the war, and in 1974, Congress passed ERISA to regulate these employer-provided plans.[59] An ERISA-qualifying plan is one that defers employee income until at least the cessation of the employment, with the aim of providing

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[55] *See id.* (describing how the offset may cause investors to be deemed to have received the proceeds of the services performed by the management company and therefore be required to pay income-level tax on that amount).

[56] *See* D. Bruce Johnsen, *Who Captures the Rents from Unionization? Insights from Multiemployer Pension Plans*, 1 AM. BUS. L. REV. 193, 211 (2012) (describing MEPPs' initial treatment in the federal statutory scheme). MEPPs are sometimes called Taft-Hartley plans in honor of their origins. *Id.* at 195.

[57] *See id.* at 215 (explaining the requirements to which MEPPs must adhere in order to comply with the Taft-Hartley Act).

[58] *Id.* at 211.

[59] *Id.*

the beneficiary with a form of retirement income.[60] Given the increasing number of workers reliant on pensions, Congress enacted ERISA to protect beneficiaries "against loss of vested pension benefits in the event of employer insolvency, withdrawal from, or termination of, their plans."[61]

To this end, Title IV of ERISA established the Pension Benefit Guaranty Corporation (the PBGC) to oversee pension plans, provide an insurance system in the event of their failure, and enforce their equitable and orderly termination.[62] The PBGC is a wholly-owned corporation of the United States government resembling the Federal Deposit Insurance Commission.[63] Companies contributing to a MEPP owe the PBGC a yearly insurance premium calculated by multiplying the number of a given employer's covered beneficiaries by a flat per-worker rate.[64] The PBGC uses these premiums to guarantee that pension beneficiaries will receive at least some portion of their benefits if their pension plans collapse.[65] As of September 30, 2012, the PBGC's MEPP insurance program was operating at a $5.2 billion deficit.[66]

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[60] Dana M. Muir & Cindy A. Schipani, *The Intersection of State Corporation Law and Employee Compensation Programs: Is it Curtains for Veil Piercing*?, 1996 U. ILL. L. REV. 1059, 1065 (defining an ERISA-qualifying employee benefits plan).

[61] David L. Gregory, *Mandatory Arbitration and Wealth Distribution: The Policies and Politics of the Multiemployer Pension Plan Amendments Act*, 24 U.C. DAVIS L. REV. 195, 200 (1990).

[62] *Id.*

[63] PETER S. GOODMAN ET AL., ABI'S PENSION MANUAL: A PRACTICAL GUIDE TO PENSION ISSUES ARISING IN BUSINESS BANKRUPTCY CASES 21 (Carol Connor Flowe et al. eds., 2006), *available at* https://www.bloomberglaw.com/legal_search/browser/105.449946.

[64] PENSION BENEFIT GUAR. CORP., PBGC Insurance of Multiemployer Pension Plans: Report To Congress Required by the Employee Retirement Income Security Act of 1974, as Amended 5 (2013), *available at* http://www.pbgc.gov/documents/pbgc-five-year-report-on-multiemployer-pension-plans.pdf.

[65] *Id.*

[66] *Id.* The PBGC estimates its liabilities by calculating the amount it expects to contribute in assistance to MEPPs already insolvent or that are expected to soon become insolvent. *Id.* As of September 30, 2012, the PBGC calculated its liabilities at $7 billion against its mere $1.8 billion in assets. *Id.* As mentioned in the Introduction, corporations face increasing pressure from their ever-growing liabilities to their underfunded pensions. That these pensions' ostensible insurer also faces massive deficits only underscores the issue.

The PBGC began insuring MEPPs in 1978[67] and quickly discovered a loophole in ERISA that gave employers an incentive to withdraw from MEPPs—an ironic twist given that Congress passed ERISA to bolster pensions, not accelerate their decline.[68] As initially written, ERISA imposed little, if any, penalty onto an employer who withdrew from a MEPP.[69] Therefore, at the first sign of a MEPP's instability, many employers would cease contributing and force the remaining sponsors to absorb the plan's underfunded balance.[70] To remedy this problem,[71] Congress passed the Multiemployer Pension Plan Amendments Act of 1980 (MPPAA).[72] Perhaps the MPPAA's most significant reform was its requirement that an employer that ceased its contributions to a MEPP pay a sum sufficient to fund its share of the plans unvested benefits for a period of time, known as a withdrawal liability payment.[73] The unvested benefits liability is the difference between the plan's current assets and the present day value of the plan's obligations to its beneficiaries.[74] Withdrawal liability payments can be very high, up to as much as $10,000 per covered employee and easily exceeding millions of dollars for MEPPs covering a medium-sized union bargaining unit.[75]

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[67] From ERISA's enactment in 1974 until 1978, the PBGC did not oversee or insure MEPPs. Gregory, *supra* note 61, at 200–01.

[68] *See id.* at 201–02 (stating that Congress and pension regulators realized that an unforeseen loophole gave employers an incentive to withdraw from MEPPs rather than continue to contribute).

[69] *Id.* at 202. Initially, ERISA only imposed penalties onto employers who withdrew from a MEPP that collapsed within five years of the employer's withdrawal. *Id.* Even then, the employer's share of the plan's unfunded benefits was capped at thirty percent of the company's net worth. *Id.*

[70] *See* John R. Woodrum & Timothy B. McBride, *Controlled Group Liability Under the Multiemployer Pension Plan Amendments Act: Liability Without Limit?*, 90 W. VA. L. REV. 731, 733–34 (1988) (explaining that because employers could withdraw from MEPPs with little threat of liability, many did so, passing the burden of financing the plan's unfunded benefits onto the remaining employers). As can easily be imagined, this increased burden on the remaining employers only further strained the MEPPs.

[71] *See id.* at 731 (explaining Congressional intent in passing the MPPAA).

[72] Multiemployer Pension Plan Amendments Act of 1980, 29 U.S.C. §§ 1381–1453 (2012).

[73] *See* GOODMAN ET AL., *supra* note 63, at 100 (identifying the purpose of withdrawal liability payments).

[74] 3 LEE T. POLK, ERISA PRACTICE AND LITIGATION § 12:7 (2013).

[75] *Id.*

Withdrawal liability may be assessed upon the occurrence of either an employer's complete[76] or partial withdrawal[77] from its MEPP.[78] These withdrawals can arise either from the employer's affirmative decision to cease contributing or from events outside its control such as the end to the collective bargaining agreement requiring the contribution or when the business falls into financial difficulty.[79] A common form of complete withdrawal, as seen in *Sun Capital*, occurs when bankruptcy forces a business's closure. It is widely accepted, and indeed the PBGC advocates, that filing a Chapter 11 bankruptcy petition is not itself a complete withdrawal.[80] However, the bankruptcy court's confirmation of the company's reorganization plan, which effectively revokes the collective bargaining agreement, generally does trigger a complete withdrawal under § 1385(a).[81] In most cases, the portion of the withdrawal liability accruing before the bankruptcy filing will be treated as general unsecured debt, leaving the union little chance of success in recouping much, if any, of the payment.[82] In a small boon for the unions, portions of the withdrawal liability accruing after the bankruptcy filing will be given more favorable treatment under the Bankruptcy Code as an administrative expense claim.[83]

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[76] *See* 29 U.S.C. § 1383 (2012) (defining complete withdrawal under the MPPAA). A complete withdrawal occurs when: (1) the employer permanently ceases to have an obligation to contribute to the MEPP pursuant the collective bargaining agreement with the union; or (2) permanently ceases all operations covered by the plan. *Id.*

[77] *See id.* § 1385 (defining partial withdrawal under the MPPAA). A partial withdrawal occurs when: (1) there is a 70% contribution decline attributable to the participating employer; or (2) there is a partial cessation of the employer's contribution obligation. *Id.*

[78] POLK, *supra* note 74, § 12:7.

[79] *See id.* (describing how the statutory imposition of withdrawal liability does not take into account why the employer is liable for the payment).

[80] John F. Wagner, Jr., Annotation, *What Constitutes Employer's "Withdrawal" from Multiemployer Pension Plan, Under § 4203 and 4205 of Employment Retirement Income Security Act (29 U.S.C.A. § 1383 and 1385), so as to Result in Liability to Plan*, 101 A.L.R. FED. 173, 179 (1991).

[81] *See id.* (citing *In re* McFarlin's Inc., 46 B.R. 88 (Bankr. W.D.N.Y. 1985)) (explaining that a bankruptcy court's confirmation of the debtor's Chapter 11 reorganization plan generally triggers a complete withdrawal).

[82] *See* 3 RONALD J. COOKE, ERISA PRACTICE AND PROCEDURE § 7:47 (2d ed. 2014) (explaining that courts have held that the portion of the bankrupt employer's withdrawal liability attributable to the post-bankruptcy filing period 15 an administrative expense that is entitled for priority).

[83] *Id.*

Realistically, though, how the bankruptcy court classifies the withdrawal liability debts makes little practical difference; either way, the union stands to receive little from the bankruptcy proceedings. Indeed, one industry expert states that in most cases, a bankrupt employer's withdrawal liability payment is only cents on the dollar.[84] Therefore, unions, like the one involved in *Sun Capital*, may look past the bankrupt employer and to § 1301(b)(1), which imposes joint and several liability for withdrawal payments onto entities classified as trades or businesses in the same common control group as the participating employer.[85]

C. *SUN CAPITAL*: FACTS AND PROCEDURAL POSTURE

On appeal, the First Circuit did not seriously dispute the district court's finding of the material facts.[86] Sun Capital Advisors, Inc. is a private equity firm headed by co-founders Marc Leder and Rodger Krouse that specializes in leveraged buyouts and other investments in underperforming, market-leading companies.[87] Sun Capital Partners III[88] and Sun Capital Partners IV (the Sun Funds), the plaintiffs in this case, are two funds Sun Capital Advisors raised and managed.[89] In most respects, the Sun Funds adhered to the typical private equity fund structure discussed earlier. Like most private equity funds, the Sun Funds

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[84] *Assessing the Challenges Facing Multiemployer Pension Plans: Hearing Before the Subcomm. on Health, Emp't, Labor and Pensions of the H. Comm. on Educ. and the Workforce*, 112th Cong. 25 (2012) [hereinafter *Assessing the Challenges*] (statement of John F. Ring, Partner, Morgan, Lewis & Bockius LLP).

[85] *See* POLK, *supra* note 74, § 12:7 (explaining that all trades or businesses under common control with the withdrawing employer will be jointly and severally liable for withdrawal liability under § 1301(b)(1)).

[86] *See* Sun Capital Partners III, LP v. New Eng. Teamsters & Trucking Indus. Pension Fund, 724 F.3d 129, 133 (1st Cir. 2013) ("The material facts are undisputed.").

[87] Sun Capital Partners III, LP v. New Eng. Teamsters & Trucking Indus. Pension Fund, 903 F. Supp. 2d 107, 109 (D. Mass. 2012), *aff'd in part*, *rev'd in part*, *vacated in part*, 724 F.3d 129 (1st Cir. 2013).

[88] Sun Capital Partners III, LP is actually comprised of two funds, Sun Capital Partners III, LP and Sun Capital Partners III QP, LP. Though separate legal entities, for ease of reference, the courts and the litigants refer to them collectively as "Sun Fund III." This Note will follow suit.

[89] *Sun Capital*, 903 F. Supp. 2d at 109.

were organized under Delaware law as limited partnerships.[90] Their limited partners included dozens of public and private pensions, university endowments, and charitable organizations.[91] As is typical of private equity funds, neither Sun Fund had any employees, owned any office space, or made or sold any goods.[92] Importantly, the Sun Funds' respective tax returns showed that each fund's income came only from investment returns.[93]

Sun Fund III's general partner is Sun Capital Advisors III, LP, and Sun Fund IV's general partner is Sun Capital Advisors IV, LP.[94] In turn, limited partner committees exercised control over the Sun Funds' respective general partners.[95] Leder and Krouse served as the sole members of the limited partner committees of the general partners of both Sun Funds.[96] Furthermore, each Sun Fund's general partner established a management company resembling those introduced earlier—Sun Capital Partners Management III, LLC (Sun Capital Advisors III, LP's management company) and Sun Capital Partners Management IV, LLC (Sun Capital Advisors IV, LP's management company).[97] These subsidiaries essentially served as conduits between Sun Capital Advisors and its portfolio companies by providing the portfolio companies management services in exchange for fees.[98]

In 2006, Sun Capital Advisors indirectly purchased Scott Brass, Inc., a Rhode Island manufacturer of industrial brass and copper coil.[99] To acquire Scott Brass, the Sun Funds organized a Delaware limited liability corporation called Sun Scott Brass as an investment vehicle.[100] Leder and Krouse, in their capacity as the members of the limited partners committee of the Sun Funds'

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[90] Appellees' Response Brief, *supra* note 22, at 5. Private equity funds are usually established in Delaware to take advantage of its sophisticated, business-friendly laws and specialized business courts. Naidech, *supra* note 23, at 3.

[91] Appellees' Response Brief, *supra* note 22, at 4–5.

[92] *Sun Capital*, 903 F. Supp. 2d at 109.

[93] Appellees' Response Brief, *supra* note 22, at 6. Specifically, the Sun Funds claimed only capital gains and dividends. *Id.* at 27.

[94] *Sun Capital*, 903 F. Supp. 2d at 110.

[95] *Id.*

[96] *Id.* at 111.

[97] *Id.*

[98] Appellees' Response Brief, *supra* note 22, at 6–7.

[99] *Sun Capital*, 903 F. Supp. 2d at 111.

[100] *Id.*

general partners, authorized Sun Fund III to invest $2.1 million into Sun Scott Brass in consideration for 70% ownership of its membership interest and Sun Fund IV to invest $900,000 in exchange for the remaining 30% interest.[101] Sun Scott Brass then invested this capital in a holding corporation, Scott Brass Holding Corp., in exchange for $1 million of the holding company's stock and $2 million in debt.[102] The holding corporation then used this $3 million in equity and $4.8 million in debt to purchase all the stock of Scott Brass, Inc.[103]

Sun Scott Brass evoked its right as shareholder of the holding company, Scott Brass Holding Corp., to appoint two Sun Capital Advisors professionals to the holding company's board.[104] The holding company then retained Sun Capital Partners Management IV, LLC, the management company subsidiary of Sun Fund IV's general partner, to provide management and advisory services to Scott Brass.[105] The management company also entered into a Master Advisory Agreement with Sun Capital Advisors to provide Scott Brass with further management services.[106] Pursuant to these contracts, the Sun Capital Advisors teams aided Scott Brass's management, endeavoring to improve the company's performance. Unfortunately, however, these efforts proved unsuccessful.[107]

In the fall of 2008, the declining price of copper rendered Scott Brass unable to obtain further credit necessary to remain in business.[108] Prior to the acquisition, Scott Brass had contributed to a MEPP benefitting employees represented by the New England Teamsters & Trucking Union (the Teamsters), but when faced with the financial shortfall, it ceased to contribute further.[109] In October 2008, Scott Brass withdrew from the MEPP and entered into bankruptcy in November.[110] As a result, the Sun Funds lost

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[101] *Id.*
[102] *Id.*
[103] *Id.*
[104] Appellees' Response Brief, *supra* note 22, at 10.
[105] *Id.*
[106] *Id.*
[107] *Id.*
[108] *Sun Capital*, 903 F. Supp. 2d at 111.
[109] *Id.*
[110] *Id.*

their entire investment in Scott Brass.[111] In December 2008, the Teamsters demanded Scott Brass pay approximately $4,516,539,[112] its withdrawal liability under 29 U.S.C. §§ 1381(a), 1383(a)(2).[113] Upon further investigation, the Teamsters also sent a demand to the Sun Funds, claiming they were liable for the payment under § 1301(b)(1) as trades or business under common control with Scott Brass.[114]

The Sun Funds then filed a declaratory judgment in district court, seeking a ruling that they were not responsible for the withdrawal liability because they were not trades or businesses and were not under common control with Scott Brass.[115] The Teamsters counterclaimed, arguing that the Sun Funds were indeed liable and further alleging that the Sun Funds' decision to structure their investment in the 70/30 ratio was an impermissible attempt to "evade or avoid" withdrawal liability under 29 U.S.C. § 1392(c).[116]

Upon cross-motions for summary judgment, the district court found that neither Sun Fund was engaged in a trade or business under § 1301(b)(1) and thus did not entertain the second part of the statute's test: the issue of common control.[117] In reaching its determination on the trade or business question, the district court looked to a series of Supreme Court tax cases interpreting the phrase as used in the Tax Code.[118] Specifically, the district court looked to *Higgins v. Commissioner*[119] and *Whipple v.*

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[111] Appellees' Response Brief, *supra* note 22, at 11.

[112] *Sun Capital*, 903 F. Supp. 2d at 111.

[113] Appellees' Response Brief, *supra* note 22, at 11.

[114] *Sun Capital*, 903 F. Supp. 2d at 111.

[115] *Id.* at 112.

[116] *Id.* The full text of § 1392(c) reads, "If a principal purpose of any transaction is to evade or avoid liability under this part, this part shall be applied (and liability shall be determined and collected) without regard to such transaction." This statute's purpose is to void transactions structured primarily to avoid contributing to an ERISA-qualified plan. Under the statute's remedial powers, courts can impose contribution obligations on the party undertaking the transaction as if it never occurred. In *Sun Capital*, the district court found for the Sun Funds on this question, *Sun Capital*, 903 F. Supp. 2d at 129, and the First Circuit affirmed. Sun Capital Partners III, LP v. New Eng. Teamsters & Trucking Indus. Pension Fund, 724 F.3d 129, 133 (1st Cir. 2013). Therefore, this Note will not discuss this argument.

[117] *Sun Capital*, 903 F. Supp. 2d at 118.

[118] *Id.* at 113–19.

[119] 312 U.S. 212 (1941).

Commissioner[120] for the proposition that under the Tax Code, an investor managing his assets, no matter how extensive that management might be, is not engaged in a trade or business if the investor does not receive non-investment return income from such management activity.[121] Building on *Higgins* and *Whipple*, the district court then turned to *Commissioner v. Groetzinger*,[122] a seminal case that established a test for when an activity constitutes a trade or business.[123] Under this test, an activity is a trade or business when its primary purpose is to earn income or profit and is undertaken with continuity and regularity.[124] The district court noted that the general consensus after *Groetzinger* is that the holdings of *Higgins* and *Whipple*—that investment management is not a trade or business—remain good law.[125]

Applying the *Groetzinger* test, the district court focused on the second prong, the activity's regularity and continuity, since the Sun Funds did not contest that they invested in Scott Brass to earn a profit.[126] The court looked to *Fulkerson* for the proposition that under the *Groetzinger* test, merely holding passive investments is not continuous or regular activity.[127] The district court emphasized that the Sun Funds made only a one-time investment into the Sun Scott Brass holding company and did not participate in managing Scott Brass because the Sun Funds were only passive investment vehicles, thus having no means with which to do so.[128] The management activities of Sun Capital Advisors' employees, rendered pursuant to contracts with the Sun Funds' general partners and their affiliated management

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[120] 373 U.S. 193 (1963).

[121] *See Sun Capital*, 903 F. Supp. 2d at 114 (citing *Higgins* and *Whipple* in discussing the relevant law it would apply).

[122] 480 U.S. 23 (1987).

[123] *Id.* at 35.

[124] *Id.*

[125] *Sun Capital*, 903 F. Supp. 2d at 113–14 (citing Cent. States, Se. & Sw. Areas Pension Fund v. Fulkerson, 238 F.3d 891, 895 (7th Cir. 2001)) (explaining that *Groetzinger* did not overturn *Higgins* and *Whipple*'s holdings that managing investments is not a trade or business).

[126] *Id.* at 116–17.

[127] *Id.* at 117 ("It is, however, well-settled that merely holding passive investment interests is not sufficiently continuous or regular to constitute a 'trade or business.' " (quoting *Fulkerson*, 238 F.3d at 895–96)).

[128] *Id.*

companies, the district court held, could not be imputed onto the Sun Funds to render them trades or businesses.[129]

On appeal, the First Circuit overruled the district court on the trade or business question as to Sun Fund IV and remanded for further factual development the same question regarding Sun Fund III, as well as the common control question as to both funds.[130] For the trade or business inquiry, the First Circuit held that the correct analysis for determining if an entity is a trade or business under § 1301(b)(1) is what it dubbed the "investment-plus" test.[131]

However, this was not the first time an adjudicatory body had applied an investment-plus-like test in a trade or business analysis. In 2007, the PBGC Appeals Board issued an opinion letter holding that a private equity fund was engaged in a trade or business under § 1301(b)(1) using a test it ostensibly derived from *Groetzinger*.[132] The PBGC found the *Groetzinger* test's first prong, that the activity is undertaken to earn a profit, satisfied when the fund's documents manifested its intentions to invest in the portfolio company to turn a profit.[133] As to the second prong, that the activity be undertaken continuously and regularly, the PBGC concluded that the fund's large size and high returns to its partners indicated that the fund must have been in operation for a

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[129] *See id.* at 116 (citing Reynolds v. Comm'r, 4 T.C.M. (CCH) 837 (T.C. 1945)) (explaining that the principal, the Sun Funds, did not take on the status of its agents, the general partner and the management companies, and therefore remained a mere passive investor).

[130] Sun Capital Partners III, LP v. New Eng. Teamsters & Trucking Indus. Pension Fund, 724 F.3d 129, 148–49 (1st Cir. 2013). See *infra* note 146, for why the First Circuit remanded the question of whether Sun Fund III was likewise engaged in a trade or business back to the district court.

[131] *Sun Capital*, 724 F.3d at 141. The concept that the mere intent to invest and make a profit does not render the investor a trade or business is relatively uncontroversial and has been recognized by numerous courts addressing withdrawal liability under § 1301(b)(1). *See, e.g.*, *Fulkerson*, 238 F.3d at 895–96 (arguing that given investing's prevalence, deeming it a trade or business, without more, would contravene § 1301(b)(1)); *see also* Bd. of Trs., Sheet Metal Workers' Nat'l Pension Fund v. Palladium Equity Partners, LLC, 722 F. Supp. 2d 854, 868 (E.D. Mich. 2010) (explaining that mere passive investment is usually insufficient to qualify as a trade or business under a *Groetzinger*-style analysis).

[132] PBGC Appeals Board, *Company "A" Pension Plan*, PENSION BENEFIT GUAR. CORP. 10 (Sept. 26, 2007), http://www.pbgc.gov/Documents/apbletter/Decision--(Liabilitywithinagroupofcompanies)2007-09-26.pdf (explaining that in answering the § 1301(b)(1) trade or business question, the *Groetzinger* test must be applied to separate purely personal activities or investments from trades or businesses).

[133] *Id.* at 11.

sufficiently continuous and regular period of time.[134] The PBGC, writing as amicus in support of the Teamsters, and the Sun Funds argued fiercely as to the proper degree of deference the court owed the PBGC's opinion letter. The First Circuit accorded it *Skidmore*[135] deference.[136] However, the First Circuit stated that it would have determined that Sun Fund IV was engaged in a trade or business even without giving the PBGC letter deference.[137]

Returning to the First Circuit's test, the court cautioned that it was not trying "to set forth general guidelines for what the 'plus' is,"[138] but stated that the inquiry must be "very fact-specific."[139] The First Circuit identified a number of factors—but advised that none were dispositive—that constituted the plus for its investment-plus test.[140]

The court first pointed to the Sun Funds' limited partnership agreements and private placement memos, stating the Funds would be actively involved in the management and operations of the portfolio companies in which they invested.[141] Specifically, the First Circuit seized on the fact that the Sun Funds prepared

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[134] *Id.* The PBGC Appeals Board also distinguished the fund from the plaintiffs in *Higgins* and *Whipple* on the basis that it was a partnership and not an individual taxpayer. *Id.* at 12. The board also attributed management involvement in the portfolio company by the fund's general partner back onto the fund itself. *Id.* at 13–14.

[135] Skidmore v. Swift & Co., 323 U.S. 134 (1944).

[136] *Sun Capital*, 724 F.3d at 140. Under *Skidmore* deference, the "weight" the court will give to an agency's determination "depend[s] upon the thoroughness evident in [the agency's] consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade." *Id.* (alterations in original) (quoting *Skidmore*, 323 U.S. at 140).

[137] *Id.* The court noted that the Seventh Circuit in *Central States Southeast & Southwest Areas Pension Fund v. Messina Products, LLC*, 706 F.3d 874 (7th Cir. 2013) applied an " 'investment plus'-like analysis" without referencing the PBGC letter to conclude that a limited liability corporation was engaged in a trade or business because it leased property to the withdrawing employer. *Sun Capital*, 724 F.3d at 141.

[138] *Sun Capital*, 724 F.3d at 141.

[139] *Id.*

[140] *See id.* at 141–43 (analyzing the specific facts of the Sun Funds' investment in and subsequent involvement with Scott Brass the court felt constituted the "plus" element of its investment-plus test).

[141] *Id.* at 142. The court found this pertinent because an entity's statements about its goals and intentions are "highly relevant, because [they] constitut[e] . . . declaration[s] against interest." *Id.* (alterations in original) (quoting McDougall v. Pioneer Ranch Ltd. P'ship, 494 F.3d 571, 577–78 (7th Cir. 2007)). The First Circuit concluded that the Sun Funds were more than mere passive investors since these statements indicated that individuals indirectly affiliated with the Funds would involve themselves in the portfolio companies' management. *Id.*

"restructuring and operating" plans for their portfolio companies even before the acquisitions closed and handpicked select investment professionals from Sun Capital Advisors' staff to lead the turnarounds.[142] The court then highlighted that the Sun Funds' indirect controlling stake in Scott Brass empowered them to appoint Sun Capital Advisors employees onto a majority of the company's board of directors.[143]

Most significantly, however, the First Circuit found that the Sun Funds' involvement in Scott Brass resulted in Sun Fund IV receiving a direct economic benefit that would not accrue to an ordinary passive investor.[144] Specifically, because Scott Brass directly paid Sun Fund IV's general partner more than $186,368.44 for its management services, Sun Fund IV was able to offset a percentage of that amount from the fees it owed its general partner and management company.[145] The First Circuit characterized this offset as income, which contradicted Sun Fund IV's claim that its only income came from investment returns.[146] After considering the above facts, the First Circuit concluded the "plus" element in its test was more than satisfied.[147]

III. ANALYSIS

A. THE FIRST CIRCUIT'S CONSTRUCTION OF § 1301(B)(1)

By establishing an ERISA-only definition of trade or business, the First Circuit seemingly contravened § 1301(b)(1)'s declaration that the phase's interpretation must be "co-extensive" with its interpretation in the Tax Code. Neither ERISA nor the MPPAA

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[142] *Id.*
[143] *Id.* at 142–43.
[144] *Id.* at 143.
[145] *Id.* This is the management fee offset provision discussed prior.
[146] *Id.* The First Circuit cited to *United States v. Clark*, 358 F.2d 892 (1st Cir. 1966) for the proposition that a taxpayer was not engaged in a trade or business partially because nothing indicated that he received compensation "different from that flowing to an investor." *Sun Capital*, 724 F.3d at 143. PBGC Appeals Board, *supra* note 132 (quoting *Clark*, 358 F.2d at 895). The First Circuit could not determine if Sun Fund III likewise received the offset's benefit and, due to this factor's importance in its analysis, ordered the district court to answer this question on remand. *Id.* at 148.
[147] *Sun Capital*, 724 F.3d at 143.

define trade or business,[148] rendering the statute's mandate that this phrase be interpreted in accordance with the tax definition all the more apparent. The statute's applicable regulations also support this contention. While § 1301(b)(1) says that "the corporation" (the PBGC) will issue the regulations governing its interpretation, the regulations themselves state "[t]he PBGC will determine that trades and businesses . . . are under common control if they are 'two or more trades or businesses under common control', as defined in regulations prescribed under section 414(c) of the [Tax] Code."[149] Section 1301(b)(1)'s legislative history also indicates that its trade or business language cannot be defined apart from the Tax Code's interpretation.[150] The same bill that enacted ERISA also enacted verbatim trade or business and control group language applicable to § 414(c) of the Tax Code.[151] Congress implemented § 414(c) as part of a legislative reform package designed to equitably and efficiently regulate qualified employee benefits plans like pensions.[152] Specifically, Congress enacted the common control element of § 414(c) to serve as an "anti-discrimination" provision to ensure that employers could not circumvent tax obligations relating to employee benefit plans by discriminatorily segmenting their operations between different corporations.[153]

Courts have looked to this same legislative history to ascertain the congressional intent behind enacting § 1301(b)(1): to ensure

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[148] Sun Capital Partners III, LP v. New Eng. Teamsters & Trucking Indus. Pension Fund, 903 F. Supp. 2d 107, 113 (D. Mass. 2012), *aff'd in part*, *rev'd in part*, *vacated in part*, 724 F.3d 129 (1st Cir. 2013); Cent. States, Se. & Sw. Areas Pension Fund v. Fulkerson, 238 F.3d 891, 895 (7th Cir. 2001).

[149] 29 C.F.R. § 4001.3(a)(1) (2013).

[150] Appellees' Response Brief, *supra* note 22, at 16.

[151] *See id.* (citing Pub. L. No. 93-406, § 1015, 88 Stat. 829, 926 (1974)) (noting that because the same legislation enacted the relevant provisions in both ERISA and the Tax Code, they must be interpreted together).

[152] *See* H.R. REP. NO. 93-807, pt. 2, at 8 (1974) ("This legislation is concerned with improving the fairness and effectiveness of qualified retirement plans in their vital role of providing retirement income.").

[153] *See* Appellees' Response Brief, *supra* note 22, at 16–17 (citing H.R. REP. NO. 93-807, pt. 4, at 50) (noting the purpose behind the common control aspect of § 414(c)). The legislative history gives the example that if an employer structured its operations so that its managers worked for an entity that provided a qualified employee benefits plan and its production employees worked for one that did not, in order to avoid the tax obligations associated with providing these plans, this would be impermissible discrimination. H.R. REP. NO. 93-807, pt. 4, at 50.

that employers could not circumvent ERISA and MPPAA obligations by similarly segmenting their operations.[154] Accordingly, that § 1301(b)(1) expressly states that its provisions will be interpreted as they are in § 414(c), that the PBGC's own regulations defer to the Tax Code to define trade or business, and that the two statutes have a common purpose all underscore the impropriety of the First Circuit's ERISA-only definition.

Even if the First Circuit was correct to establish an ERISA-only definition of trade or business, the First Circuit's analysis still seems flawed, given Congress's intent behind enacting § 1301(b)(1) and § 414(c)—preventing employers from fractionalizing their operations to avoid the ERISA and tax obligations associated with sponsoring qualified employee benefit plans. No such fractionalization occurred during Sun Fund IV's involvement with Scott Brass. While professionals from Sun Capital Advisors suggested operational improvements to Scott Brass's management, no impermissible restructuring of the company's operations resembling the example provided in the legislative history occurred. After the acquisition, Scott Brass continued to pay its MEPP obligations until it entered into bankruptcy and nothing indicates that it shirked the tax obligations associated with providing a qualified employee benefits plan. The only major changes arising from the acquisition were Scott Brass's new ownership and the involvement of Sun Capital Advisors employees, and nothing about those changes seems to implicate § 1301(b)(1).

The Seventh Circuit has recognized that whatever its purpose, Congress did not enact § 1301(b)(1) to make corporate owners "dig into their pockets to make good the withdrawal liability of their corporations."[155] Given that § 1301(b)(1)'s legislative history clearly indicates its purpose, the First Circuit's statutory construction by necessity runs afoul of *Messina Products*'s directive that the statute may not be used to make corporate

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[154] *See* Mason and Dixon Tank Lines, Inc. v. Cent. States, Se. & Sw. Areas Pension Fund, 852 F.2d 156, 159 (6th Cir. 1988) (looking to legislative history to divine § 1301(b)(1)'s purpose); Bd. of Trs. of W. Conference of Teamsters Pension Trust Fund v. H.F. Johnson, Inc., 830 F.2d 1009, 1013 (9th Cir. 1987) (same).

[155] Cent. States Se. & Sw. Areas Pension Fund v. Messina Prods., LLC, 706 F.3d 874, 880 (7th Cir. 2013) (quoting Cent. States, Se. & Sw. Areas Pension Fund v. Slotky, 956 F.2d 1369, 1374 (7th Cir. 1992)) (internal quotation marks omitted).

owners liable for withdrawal payments outside a finding that they owned an entity engaging in a trade or business. Because Sun Fund IV was not engaged in a trade or business under a proper reading of § 1301(b)(1), it ought not be made to empty its pockets to satisfy the withdrawal liability.

B. THE INVESTMENT-PLUS TEST AND THE PBGC OPINION LETTER

As a starting point for examining the First Circuit's test, the court accorded the PBGC Appeals Board letter *Skidmore* deference because it found the letter persuasive.[156] However, in doing so, the First Circuit seemingly acknowledged that applying § 1301(b)(1) to a private equity fund constituted a foray into an uncertain area of law. It expressed "dismay" over the PBGC's failure to provide any guidance subject to public comment on the interpretation of trade or business and acknowledged that the PBGC's test "leaves open many questions about exactly where the line should be drawn"[157] when deciding whether an activity is a trade or business.[158]

The First Circuit apparently collapsed its reasons for finding the PBGC letter persuasive into the defense of its own investment-plus test; thus, ascertaining the precise reasons why the court gave the letter deference are unclear. In fact, the only specific mention of the PBGC letter in the heart of the court's analysis is a brief note that, like the general partner of the fund at issue in the PBGC letter, Sun Fund IV's general partner also received compensation from a management fee and a percentage of the fund's profits.[159] Avoiding the risk of impugning arguments onto the court that it did not make necessitates moving onto the First Circuit's own investment-plus test.[160] Unfortunately for the First

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[156] *See supra* note 136 and accompanying text.

[157] Sun Capital Partners III, LP v. New Eng. Teamsters & Trucking Indus. Pension Fund, 724 F.3d 129, 148 (1st Cir. 2013).

[158] The line between these types of activities must be drawn with care since under the Tax Code and, by extension, ERISA, trades or businesses constitute only a "narrow category" of the "broad range of income or profit producing activities." Whipple v. Comm'r, 373 U.S. 193, 197 (1963).

[159] *Sun Capital*, 724 F.3d at 142.

[160] For a critique of the PBGC letter, see Sun Capital Partners III, LP v. New Eng. Teamsters & Trucking Indus. Pension Fund, 903 F. Supp. 2d 107, 115–16 (D. Mass. 2012), *aff'd in part*, *rev'd in part*, *vacated in part*, 724 F.3d 129 (1st Cir. 2013). The district court declined to accord the letter deference, holding that it misinterpreted the Supreme Court

Circuit, however, its criticisms of the PBGC's open-ended, unclear test may also be fairly leveled at its own test, in turn.

C. THE INVESTMENT-PLUS TEST'S DEPARTURE FROM *GROETZINGER*

The court seemingly adopted its investment-plus test as an alternative to the previously introduced *Groetzinger* test[161] when applying § 1301(b)(1). Admittedly, the First Circuit made a valid argument in pointing out that *Groetzinger* addressed the trade or business phrase in a Tax Code provision other than § 414(c), and that it did not purport to establish an all-encompassing definition of trade or business.[162] However, the overwhelming majority of courts interpreting trade or business—including those doing so for § 1301(b)(1)—nevertheless rely upon the *Groetzinger* test,[163] and indeed the First Circuit only cited two cases concerning a § 1301(b)(1) trade or business determination that did not rely on *Groetzinger*.[164] Additionally, the PBGC itself conceded that "courts generally . . . use" the *Groetzinger* test for the trades and business question and rooted its own analysis in the *Groetzinger* test's two elements.[165] That the First Circuit's opinion joins the small number of outliers that did not utilize a *Groetzinger*-based test in a § 1301(b)(1) trade or business analysis provides ample grounds to view it askance. In many decades since courts began to use the *Groetzinger* test, no legislative or adjudicatory body has issued laws or regulations that provide grounds to question *Groetzinger*'s applicability to this issue, let alone definitively establish a

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tax cases and misconstrued the laws of agency by attributing actions of the Fund's general partner and management company onto the Fund itself. *Sun Capital*, 724 F.3d at 142.

[161] *See supra* notes 122–24 and accompanying text.

[162] *See Sun Capital*, 724 F.3d at 145 (citing Comm'r v. Groetzinger, 480 U.S. 23, 27 n.8 (1987) (cautioning that *Groetzinger* did not purport to provide a universal Tax Code definition of trade or business)).

[163] *See, e.g.*, Cent. States, Se. & Sw. Pension Fund v. Personnel, Inc., 974 F.2d 789, 794 (7th Cir. 1992); Connors v. Incoal Inc., 995 F.2d 245, 250 (D.C. Cir. 1993); Bd. of Trs. v. Del. Valley Sign Corp., 945 F. Supp. 2d 649, 655 (E.D. Va. 2013); *see also* Cent. States, Se. & Sw. Areas Pension Fund v. Fulkerson, 238 F.3d 891, 895 (7th Cir. 2001) ("While *Groetzinger* was interpreting only a specific provision in the tax code, its test comports with the common meaning of trade or business and thus can be used more generally.").

[164] *See Sun Capital*, 724 F.3d at 145 (citing Carpenters Pension Trust Fund for N. Cal. v. Lindquist, 491 F. App'x 830 (9th Cir. 2012); Bd. of Trs. of the W. Conference of Teamsters Pension Trust Fund v. Lafrenz, 837 F.2d 892 (9th Cir. 1988)).

[165] *See* PBGC Appeals Board, *supra* note 132, at 10 (acknowledging that *Groetzinger* generally applies and basing its own analysis off of it).

definition for trades or businesses. It bears repeating that the agency charged with issuing § 1301(b)(1)'s controlling regulations, the PBGC, endorsed *Groetzinger* in its Appeals Board letter.[166] Until Congress or the agencies speak definitively to the contrary, a *Groetzinger*-based test for a trade or business inquiry should be utilized, and courts' decisions, like the First Circuit's, that deviate from such a test merit skepticism. This is especially true here since the First Circuit acknowledged that *Sun Capital* should not be read as providing a general blueprint for how to conduct an investment-plus analysis, but instead that the test should be driven by a case-specific, fact-intensive inquiry.[167] The Supreme Court has noted such analyses with disfavor, especially when they are inserted into settled areas of law.[168]

D. THE INVESTMENT PLUS TEST CONFLICTS WITH *HIGGINS* AND *WHIPPLE*

The First Circuit said its test was consistent with Supreme Court tax precedent, but parsing the First Circuit's analysis and comparing it to those in the tax cases reveals otherwise, providing additional grounds for questioning *Sun Capital*. As mentioned above, *Higgins* and *Whipple* established that a taxpayer who makes and manages investments and receives income only from returns on those investments is not engaging in a trade or business.[169] Specifically, in *Higgins*, the taxpayer owned considerable investments in the stock market and real estate, and he hired staff to help oversee his holdings and rented office space for their use.[170] The taxpayer's "managerial attention" earned him "interests and dividends from his securities," but the Court held that those facts, as a matter of law, did not and could not render

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[166] While the PBGC was correct to base its test upon *Groetzinger*, it misinterpreted the case, and its resulting investment-plus test is flawed due to this misreading.

[167] *See supra* note 138 and accompanying text (noting the opinion is not intended to provide general guidelines for identifying the plus in an investment-plus test).

[168] *See* Brief for the Private Equity Growth Capital Council, *supra* note 21, at 2 (pointing to the Court's observation that case-specific, multifactor tests "[jettison] relative predictability for the open-ended rough-and-tumble of factors, inviting complex argument in a trial court and a virtually inevitable appeal" (quoting Jerome B. Grubart, Inc. v. Great Lakes Dredge & Dock Co., 513 U.S. 527, 547 (1995))).

[169] *See supra* notes 119–21 and accompanying text.

[170] Higgins v. Comm'r, 312 U.S. 212, 212 (1941).

his activities a trade or business, no matter "how large the estate or how continuous or extended the work required may be."[171] The Court underscored this point in *Whipple* where the taxpayer involved himself in the affairs of multiple partnerships and corporations that he controlled.[172] Involving oneself in businesses in which one has invested, "without more," is not a trade or business, the Court held, even if "such activities may produce income, profit or gain in the form of . . . enhancement in the value of an investment," because these gains are "distinctive to the process of investing."[173]

When the only income received is that of an ordinary investor, the taxpayer is not engaged in a trade or business, and because investing is not a trade or business, "the return to the taxpayer, though substantially the product of his services, legally arises not from his own trade or business but from that of the corporation."[174] Accordingly, the Court said it was "untenable" to claim that one who "actively engages in serving his own corporations for the purpose of creating future income through those enterprises is in a trade or business."[175] *Groetzinger*, in holding that gambling could be a trade or business, not only established its test that to be a trade or business the activity must have a profit motive and be undertaken with continuity and regularity, but also explicitly endorsed *Higgins*.[176]

The First Circuit's test, despite the court's claims to the contrary, is not consistent with these precedents. Even though the First Circuit did not use *Groetzinger* in its investment-plus test, it nevertheless incorrectly stated the investment-plus test accorded with it.[177] That the First Circuit's investment-plus test seemingly contravenes both *Higgins* and *Whipple*, by necessity, brings it into

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[171] *Id.* at 218.
[172] Whipple v. Comm'r, 373 U.S. 193, 195 (1963).
[173] *Id.* at 202.
[174] *Id.*
[175] *Id.* at 203.
[176] *See* Comm'r v. Groetzinger, 480 U.S. 23, 35 (1987) ("We do not overrule or cut back on the Court's holding in *Higgins* . . . .").
[177] *See* Sun Capital Partners III, LP v. New Eng. Teamsters & Trucking Indus. Pension Fund, 724 F.3d 129, 146 (1st Cir. 2013) ("The 'investment-plus' test as we have construed it in this opinion is thus consistent with the *Groetzinger*, *Higgins*, and *Whipple* line of cases.").

conflict with *Groetzinger*,[178] despite the court's attempts to avoid the issue altogether by discounting *Groetzinger*'s test in favor of its own. The court strove to prove that its test did not conflict with *Higgins* and *Whipple* through a series of distinctions;[179] however, its attempts ultimately seem inadequate. The holding that investment management where the investor does not receive non-investment return income is not a trade or business is ultimately one of substance, not style. That Sun Fund IV's investment activities in Scott Brass were on a more sophisticated, grander scale than those of the individuals in *Higgins* and *Whipple* is beside the point.

The First Circuit first attempted to distinguish Sun Fund IV from the taxpayer in *Higgins* on the basis that he was an individual trying to claim tax deductions.[180] While certainly true, it is doubtful whether this distinction carries much significance. The activity at issue in *Higgins* was investment management, which the Supreme Court has held is not a trade or business. Sun Fund IV, like the taxpayer in *Higgins*, made and managed investments and did not receive income apart from investment returns—which are the relevant factors in whether the investment management is a trade or business. Therefore, that *Higgins* arose over contested tax deductions does not change the fact that Sun Fund IV and the *Higgins* taxpayer resemble each other as to the controlling factors.

The First Circuit also tried to distinguish *Higgins* on the basis that the taxpayer, unlike Sun Fund IV, did not participate in the management of the corporations in which he owned interests.[181] This is also a true but irrelevant distinction. *Higgins*, *Whipple*, and *Groetzinger* together clearly hold that involvement in the corporations in which one is a shareholder or investor does not render the investing a trade or business. *Higgins* stated that devoting "managerial attention" to investments, no matter how large the holdings or extensive that attention may be, was not

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[178] This is so because *Groetzinger* reaffirmed *Higgins*'s holding that investment management in which the investor does not receive income other than investment returns is not a trade or business. *See supra* note 176 and accompanying text.

[179] *Sun Capital*, 724 F.3d at 145–46.

[180] *Id.* at 145.

[181] *Id.*

engaging in a trade or business.[182] *Whipple* made the point more strongly, stating that even "*actively* engag[ing]" in management of one's corporations was not a trade or business.[183] Therefore, Sun Fund IV's indirect involvement in Scott Brass for the purpose of overseeing its investment is not a valid distinction between *Sun Capital* and *Higgins*.

The First Circuit's attempts to distinguish *Sun Capital* from *Whipple* also seemingly confuse the precedents. As an initial matter, the First Circuit proposed that it was difficult to see how its investment-plus test differed from *Whipple*'s "without more" language.[184] This is true to an extent. However, the "plus" factors the First Circuit focused on—the documents manifesting the Sun Funds' general partners' intentions to involve themselves in their portfolio companies, the Sun Capital Advisors' employees providing managerial and consulting services to Scott Brass, and the presence of Sun Capital Advisors employees on Scott Brass's board—do not offend *Whipple*'s "without more" formulation. All these actions do not appear meaningfully different from those undertaken by interested, active, and involved shareholders and investors who the tax cases say are not engaged in trades or businesses.[185] An investor or shareholder would breach *Whipple*'s "without more" threshold by receiving "a reward . . . different from that flowing to an [ordinary] investor."[186] Receipt of non-investment income would also violate *Higgins*—and, by implication, Groetzinger—where the taxpayer "merely . . . collected interests and dividends."[187] However, because Sun Fund IV did not receive income other than returns on its investments, it satisfies the Supreme Court tax cases' tests. By extension, therefore, because Sun Fund IV failed the First Circuit's

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[182] Higgins v. Comm'r, 312 U.S. 212, 218 (1941).

[183] Whipple v. Comm'r, 373 U.S. 193, 203 (1963) (emphasis added).

[184] *Sun Capital*, 724 F.3d at 146.

[185] In their briefs, the Sun Funds compared themselves to an individual controlling shareholder of a closed corporation who votes in a board of directors that will oversee the corporation according to the shareholder's preferred style and will appoint one of their own or someone else of a like mind to manage the company in that manner. Appellees' Response Brief, *supra* note 22, at 35. Again, *Higgins* and *Whipple* seem fundamentally more focused on substance than style, and this analogy drives home the point that the Sun Funds, at their essence, did not act differently from how an individual controlling shareholder could.

[186] *Whipple*, 373 U.S. at 203.

[187] *Higgins*, 312 U.S. at 218.

investment-plus test, this test cannot be viewed as consistent with *Whipple*.

The First Circuit concluded that Sun Fund IV received income other than investment returns due to the benefit of the management-fee offset from fees Scott Brass paid directly to the management company subsidiary of Sun Fund IV's general partner.[188] While the potential policy ramifications of this will be discussed later, as a legal matter, it appears the First Circuit erred in considering the management-fee offset income for the purposes of its investment-plus test. The Sun Funds' tax returns showed their only income came from investment returns.[189] In a footnote, the First Circuit admitted this "[cut] in favor of the Sun Funds' argument" but nevertheless deemed the offset income and placed great significance upon this determination.[190] However, as the district court recognized, the offset is a form of a reimbursement, which is not considered income at all.[191] This view is widely held within the private equity industry, as well.[192]

Counting the management fee offset as income and using it to find that Sun Fund IV engaged in a trade or business seems to contravene settled tax law and certainly runs contrary to widespread belief within the private equity industry. This departure from prior, settled law provides further reason to cast a suspicious eye on the First Circuit's test.

Before turning to *Sun Capital*'s potential policy implications, I join the First Circuit in lamenting Congress and the regulatory

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[188] *Sun Capital*, 724 F.3d at 146.

[189] *Id.* at 134.

[190] *Id.* at 143 n.22.

[191] *See* Sun Capital Partners III, LP v. New Eng. Teamsters & Trucking Indus. Pension Fund, 903 F. Supp. 2d 107, 118 (D. Mass. 2012) ("A reimbursement is in the nature of repayment of borrowed funds, which is not taxable." (quoting Muegge v. Comm'r, 2000 WL 1056473, at *4 (T.C. 2000))), *aff'd in part*, *rev'd in part*, *vacated in part*, 724 F.3d 129 (1st Cir. 2013); *see also* Gulf Life Ins. Co. v. United States, 35 Fed. Cl. 12, 19 (1996) ("The reimbursement is therefore in the nature of a repayment of borrowed funds, which is not gross income. Thus, the dividend reimbursements are not income . . . ."), *aff'd*, 118 F.3d 1563 (Fed. Cir. 1997).

[192] *See, e.g.*, STEPHANIE R. BRESLOW & PHYLISS A. SCHWARTZ, PRIVATE EQUITY FUNDS: FORMATION AND OPERATION 2–72 (2010) (explaining that because funds do not directly receive these offsets for any activities they conduct, they should not cause funds to be considered trades or businesses). Private equity funds obtain the offsets via the management company receiving fees from other sources for conducting its own trade or business—providing management and advisory services to portfolio companies. *Id.*

agencies' failures to provide guidance concerning how trades or businesses should be interpreted in both the ERISA and Tax Code. Admittedly, the First Circuit's analysis constituted a foray into an unsettled area of law where the distinctions between trades or businesses and other income-generating activities are indeed drawn by narrow, hazy lines. However, given Congress and the agencies' failure to act, the First Circuit's best guidance was § 1301(b)(1)'s clear language and legislative history—which seemingly forbid an ERISA-only definition of trade or business—and the body of law fashioned by *Higgins*, *Whipple* and *Groetzinger*. After erroneously unbridling itself from the direction at its disposal, the court fashioned an investment-plus test that rests upon at least highly questionable legal grounds and offers limited practicality, as its fact-intensive, case-specific inquiry may ultimately leave sponsors with more questions than meaningful guidance. In sum, the First Circuit's test should be rejected as a matter of law. That is not the end of the matter, however; *Sun Capital*'s inadequacies also reveal themselves in the negative policy ramifications the decision may very well engender.

IV. *SUN CAPITAL*'S POTENTIAL POLICY RAMIFICATIONS

In analyzing the potential policy implications that may emerge from *Sun Capital*, some measure of restraint is appropriate. After all, in deciding that Sun Fund IV was a trade or business, the First Circuit wrote less than half the story. On remand, the district court must determine if Sun Fund III is also a trade or business—the First Circuit indicated that this may turn on little more than whether the Fund also utilized the management fee offset—and if the Sun Funds were under common control with Scott Brass.[193] But, however these issues are resolved, the First

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[193] For the Sun Funds to be liable for the withdrawal liability, the question of common control must also be resolved in the Teamsters' favor. Many experts predict this is unlikely to occur. *See, e.g.*, Andrew L. Oringer, *Is the First Circuit Egregiously Aggregating? Sun Capital Partners Case Holds That a Private Equity Fund Could Have ERISA Liabilities of Its Portfolio Company,* DECHERT LLP (Aug. 2013), http://www.dechert.com/Is_the_First_Circuit_Egregiously_Aggregating_Sun_Capital_Partners_Case_Holds_That_a_Private_Equity_Fund_Could_Have_ERISA_Liabilities_of_Its_Portfolio_Company_08-09-2013/ (proposing that it is unlikely the Sun Funds will be deemed under common control with Scott Brass). Unlike the law in trade or business issue, the law governing of common control is well defined with a fairly straightforward analysis. Generally, an entity must own at least an 80% interest in another

Circuit's ruling on its own is sufficiently problematic as a matter of policy. *Sun Capital* directly implicates and may very well negatively affect two present, abundantly clear realities: private equity plays an important role in the American economy,[194] and MEPPs and their participating employers are on the brink of financial crisis.[195]

A. THE IMPLICATIONS FOR MEPPS AND THEIR SPONSORING EMPLOYERS

As a broad point, reexamining the basic nature of private equity funds may help illuminate what is really at stake from a practical perspective. At their heart, these funds are little more than a mechanism to pool investors' capital (the limited partners) and get it into the hands of sophisticated investors (the general partner and its affiliates). If Sun Fund IV, or any private equity fund, is made to pay a MEPP's withdrawal liability, it is important to recognize that it is the limited partners' money that will chiefly be used to satisfy the judgment.[196] Aside from the limited partners' contributions and the returns from investing this capital, private equity funds have little else of value. Although general partners are exposed to unlimited liability for the partnership's debts and other obligations, as seen in *Sun Capital*, most general partners are structured as LPs or LLCs to insulate their owners (almost

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entity for the two to be deemed under common control. *Id*. Because neither Fund's ownership stake reached that threshold, outside the discovery of additional facts or unexpected judicial analysis, the Sun Funds will likely not be aggregated into a single employer along with Scott Brass. *Id*.

[194] *See generally* Robert J. Shapiro & Nam D. Pham, *American Jobs and the Impact of Private Equity Transactions*, THE PRIVATE EQUITY GROWTH CAPITAL COUNCIL (Jan. 17, 2008), http://www.pegcc.org/wordpress/wp-content/uploads/pec-jobs-study-01-17-08.pdf (analyzing the job growth in companies acquired by private equity funds).

[195] *See generally Assessing the Challenges*, *supra* note 84 (explaining that many MEPPs are severely underfunded and the resultant financial strain on their participating employers).

[196] As discussed in the Introduction, sponsors do contribute their own money into the funds they raise. *See supra* notes 33–34 and accompanying text. However, the limited partners' contributions dwarf those of the sponsors. The IRS previously required general partners to contribute at least 1% of partnerships' total capital, and that benchmark has remained relatively common in the industry. BRESLOW & SCHWARTZ, *supra* note 192, at 3–7. More recently, fund advisors have been trending towards counseling general partners to contribute the lesser of $500,000 or .20% of their funds' total assets to ensure that they will be considered true members of the partnership for tax reasons. *Id*. at 2–28. For marketing purposes, however, most will contribute more than this bare minimum.

always the sponsors) from such liability.[197] While limited partners' liabilities are almost always capped at the extent of their unpaid capital commitments and share of the profits,[198] one can only imagine how the conversation would unfold if a fund's sponsor called a major institutional investor with the news that its investment was being seized to satisfy a judgment to a union pension plan. Of course, many pension plans, including pensions affiliated with unions, serve as private equity limited partners. Perhaps *Sun Capital*'s greatest (assuredly unintended) irony is that by creating the potential for private equity funds to be responsible for withdrawal liabilities, the First Circuit has made it so that one MEPP's assets could be taken from it and used to satisfy another MEPP's withdrawal liability. Perhaps Peter would not be getting robbed so that Paul could get paid, but he certainly would be forced to open his checkbook for Paul's benefit.

As is easily imagined, no private equity sponsor wants to incur the reputational harm associated with failed investments, let alone the news headline that its funds have been forfeited to pay withdrawal liabilities. The private equity industry prizes pre-investment risk identification and assessment.[199] Given the millions of dollars that could be at stake were a fund exposed to withdrawal liability, sponsors may very well decide that investments in distressed companies contributing to underfunded MEPPs and subject to withdrawal liability are simply not worth the risks. By disincentivizing private equity from investing in troubled companies contributing to MEPPs, the First Circuit has increased the chance these companies will miss out on their last best shot to remain solvent. Private equity sponsors, with their large amounts of capital and managerial expertise, are the ideal white knights for troubled companies. In fact, within the last five years, private equity firms have invested almost $30 billion into 1,987 U.S.-based bankrupt companies and successfully

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[197] *See* BRESLOW & SCHWARTZ, *supra* note 192, at 3–6 (explaining how fund sponsors solve the problem of the general partners' unlimited liability).

[198] *See id.* at 2–93 (defining the extent of limited partners' liabilities).

[199] *See* Brief of the Private Equity Growth Capital Council, *supra* note 21, at 3 (citing Michael Boskin, *Investors Want Clarity Before They Take Risks*, WALL ST. J., Jan. 23, 2009, at A16) (describing private equity's important practice of pre-investment risk assessment).

rehabilitated them, protecting the jobs of their more than 250,000 employees in the process.[200]

B. THE IMPLICATIONS FOR PRIVATE EQUITY FUNDS AND THEIR INVESTORS

A major part of the risk private equity funds may now face comes from the investment-plus test's vagueness. With a fact-intensive, case-specific inquiry at its core, the First Circuit's test fails to provide sponsors with much substantive guidance as to how they should structure their funds and investments in companies contributing into MEPPs. What guidance can be gleaned is surely not encouraging. In its condemnation of Sun Fund IV, the investment-plus test keyed upon common features of private equity funds and their transactions, including the management fee offset, Sun Fund IV's sponsors' intent to oversee the Scott Brass investment, and Sun Capital Advisors professionals providing management and advisory services to Scott Brass. Because sponsors need to ensure that their portfolio companies are effectively managed, and because the practices condemned by the First Circuit are essential to this management, some question whether funds and their sponsors will be able to sufficiently adjust their practices to avoid classification as a trade or business under the First Circuit's test.[201] Therefore, modifying their behavior to the extent suggested by the investment-plus test[202] may likely be extremely unpalatable to fund sponsors, as doing so would compromise much of private equity's essential character.

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[200] THE PRIVATE EQUITY GROWTH CAPITAL COUNCIL, *Fact & Fiction*, http://www.pegcc.org/education/fact-and-fiction/ (last visited Aug. 11, 2013).

[201] *See, e.g.*, *Alert Update: First Circuit Court of Appeals Concludes That Private Equity Funds Can Be Liable for Portfolio Company Pension Obligations*, SIMPSON THACHER & BARTLETT LLP 2 (Aug. 1, 2013), http://www.stblaw.com/docs/default-source/cold-fusion-existing-content/publications/pub1636.pdf?sfvrsn=2 (proposing that given the First Circuit's focus upon important private equity industry practices, it may not be possible for most funds to avoid classification as a trade or business under the First Circuit's test).

[202] Of course, even doing so may be fairly unhelpful, given that the court cautioned that no one factor was "dispositive in and of itself." This makes it difficult for sponsors to know what characteristics of their funds they ought to consider worrisome. *See supra* notes 139–40 and accompanying text.

Disregarding the management fee offset would be easier for sponsors to accomplish, but would also be problematic for funds and their investors. The management fees that funds, through the limited partners, pay the general partner and its affiliated entities are a constant source of friction in a private equity relationship.[203] Since management fees are calculated as a fixed percentage of assets under management, limited partners worry that as funds become larger, and their managers start receiving higher amounts of fee income, general partners lose the incentive to make riskier but potentially more rewarding investments.[204] Offsetting management fees from fees the general partner and its affiliates collect from portfolio companies[205] is therefore a primary way fund sponsors can correct the perceived misalignment of interests and placate their limited partners.[206] That *Sun Capital* placed these offsets in its crosshairs could incentivize sponsors to discontinue their use, which would have multiple negative consequences for both the funds and their investors, including MEPPs.

The offset serves as a strong marketing point for funds; when limited partners pay lower management fees, more of their money works for them in the funds' investments. If sponsors feel constrained by *Sun Capital* to do away with these offsets, they may be less successful in raising funds. Smaller funds mean less private equity capital will be invested into the national economy, including distressed companies contributing to MEPPs. To the extent sponsors can still raise funds, eliminating the offsets necessarily entails less returns for the limited partners,[207] since more of their capital must go towards the management fees.

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[203] *See* JOSH LERNER ET AL., PRIVATE EQUITY & VENTURE CAPITAL: A CASEBOOK 71 (5th ed. 2012) (explaining that limited partners and general partners often bicker over management fees paid from the fund's assets).

[204] *See id.* (describing how general partners and investors' interests may become misaligned if management fees become too large).

[205] In the industry, the various fees general partners receive from portfolio companies are collectively called transaction fees. LERNER ET AL., *supra* note 203, at 72.

[206] *See* BRESLOW & SCHWARTZ, *supra* note 192, at 2–70 (describing the purpose of the management fee offset). The management fees the fund must pay the general partner and other entities come from the fund's holdings. Therefore, the limited partners want the offset percentage to be as high as possible so that more of their money can work for them in the funds' investments rather than pay the managers' fees. Naidech, *supra* note 23, at 9.

[207] *See* Brief of the Private Equity Growth Capital Council, *supra* note 21, at 4–5 (explaining that eliminating the offsets would result in diminished returns for investors, including MEPPs).

In holding that Sun Fund IV was a trade or business and thereby incentivizing private equity funds to divert their capital away from companies contributing to MEPPs, the First Circuit appears to have contravened congressional intent in enacting the employee benefits statutory scheme. As constructed, ERISA laws struck a measured balance between "encoura[ging] the operation and continuation of private pension plans" and "protect[ing] employees' pension benefits."[208] By its interpretation of § 1301(b)(1), the First Circuit certainly took a large step towards ensuring that the employees of Scott Brass would receive the entirety of their pension benefits. However, in doing so, the court placed a heavy thumb on ERISA's balanced scale, as its construction seemingly disregards ERISA's additional purpose, fostering private sector control of pension plans. If private equity is disincentivized from propping up pensions most in need of help—those sponsored by financially struggling employers—the chances that these pensions will need the PBGC to intervene to bolster them are greatly increased. Given the PBGC's own poor financial health,[209] this would be an undesirable state of affairs for all parties involved. While the employees covered by the Teamsters' MEPP might have cheered *Sun Capital*, their hope may come at the expense of the 10 million other American workers[210] dependent on MEPPs.

V. CONCLUSION

In *Sun Capital*, the First Circuit interpreted trade or business in § 1301(b)(1) in a novel and ultimately flawed manner. In place of the clarity offered by the Supreme Court tax cases, the First Circuit's unclear, vague investment-plus test promises to sow confusion and uncertainty within an industry that prizes careful considerations of risk prior to investing.[211] Because what is good for private equity is ultimately beneficial for troubled companies—

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[208] *See In re* Challenge Stamping & Porcelain Co., 719 F.2d 146, 150 (6th Cir. 1983) (quoting A-T-O, Inc. v. Pension Benefit Guar. Corp., 634 F.2d 1013, 1025 (6th Cir. 1980)) (describing ERISA's balancing of different policy aims).

[209] *See supra* note 66.

[210] *Assessing the Challenges*, *supra* note 84, at 14 (statement of Josh Shapiro, Deputy Exec. Dir. for Research and Educ., Nat'l Coordinating Comm. for Multiemployer Plans).

[211] *See supra* note 199 and accompanying text.

some of which contribute to pensions including MEPPs—looking to receive private equity investments for their rehabilitation, *Sun Capital* may have a derivative harmful effect on the long-term health of MEPPs as well. While this case is troublesome, the final chapter on this issue may not yet be written. Should a split arise between the First Circuit and a sister circuit over the interpretation of § 1301(b)(1) as it pertains to private equity funds,[212] the Supreme Court may resolve the conflict and provide the final word. Until, or if, that day comes to pass, we must learn to live with *Sun Capital* and strive to provide guidance to both private equity funds and MEPPs as they venture into their now uncertain future.

Crighton Thomas Allen

[212] *See* Oringer, *supra* note 193 (explaining that other federal appellate courts may soon examine this issue).