Investment Funds Not Liable for Portfolio Company's Multiemployer Pension Plan Withdrawal Liability

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PRACTICES Employee Benefits and Executive Compensation, Investment Management

A federal court recently held that two investment funds are not jointly and severally liable for a bankrupt portfolio company?s withdrawal liability to a multiemployer pension plan disagreeing with a 2007 opinion by the Appeals Board of the Pension Benefit Guaranty Corporation (the ?PBGC?). The Massachusetts U.S. District Court ruled there was no liability because the investment funds are not ?trades or businesses? for purposes of ERISA?s joint and several liability rules. This is the first court to address this issue since the PBGC Appeals Board ruled that an investment fund could be engaged in a trade or business.

ERISA imposes joint and several liability for an underfunded pension plan upon any entity which is, on the plan?s termination date, a contributing sponsor of the plan or any member under common control with the sponsor. In general, common control can be established where one organization owns 80 percent or more of another, provided the owning organization also is a ?trade or business.? In the 2007 opinion, the PBGC rejected the widely accepted argument that an investment fund is a passive investment vehicle and is not engaged in a trade or business. The PBGC determined that the general partner of the investment fund had the ultimate authority regarding the day-to-day management activities of the fund, and those activities constituted a trade or business where the primary purpose for engaging in those activities was generating income or profit and the activities were conducted with continuity and regularity.

In the case before the district court, two investment funds (collectively, the ?Funds?), acquired a 100 percent ownership interest in the portfolio company (the ?Company?). The Company eventually entered bankruptcy and stopped making its required contributions to a multiemployer pension plan. The pension plan assessed withdrawal liability against the Company and sought to recover from the Funds, asserting they were jointly and severally liable because they were a trade or business under common control with the Company. The court disagreed and granted the Funds? motion for summary judgment.

The court held that each Fund was merely a passive investor, and not a trade or business continuously or regularly engaged in managing the Company. The court concluded that the Funds? one-time investment in the Company was not sufficiently continuous or regular to constitute a trade or business. Moreover, the Funds had no employees, no office space, and did not make or sell any goods. The Funds? involvement with the management and oversight of the Company, such as electing members of the Company?s board of directors, was no more than that of an ordinary shareholder.

Although the court?s holding appears to revert to what was, prior to the 2007 PBGC opinion, the widely accepted argument that a mere investment by a fund in a portfolio company is insufficient to impose joint and several pension liability, until an appellate court addresses the issue, investment funds should continue to be aware of the PBGC opinion with respect to their current investments, as well as their future transactions, especially ones involving significant investments in portfolio companies that sponsor one or more defined benefit pension plans, including multiemployer pension plans.

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