THOMPSON HINE

Business Law Update

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Mergers & Acquisitions

Avoiding Common Hart-Scott-Rodino Pitfalls

By Rachel G. Talay, Michael W. Jahnke and Barry M. Block

Actions by the Federal Trade Commission (FTC) and the Antitrust Division of the Department of Justice (DOJ) in 2012 and 2013 remind us of some often overlooked aspects of the Hart-Scott-Rodino Act (HSR Act). The HSR Act requires some companies or individuals to file premerger notifications with the FTC and DOJ and to observe a waiting period before consummating certain acquisitions. The notification and waiting period are intended to give the federal antitrust agencies prior notice of proposed transactions and to allow them to determine whether a transaction may violate antitrust laws.

Companies (and their officers and directors) and other purchasers are well advised to consult with counsel to set up ongoing HSR Act compliance programs to avoid some of these common pitfalls.

- **Limited scope of passive investor exemption:** The HSR Act includes an exemption for purchases of voting securities made solely for the purpose of investment where the purchaser would hold 10 percent or less of the outstanding voting securities of an issuer.[1] The limited scope of the exemption often traps unwary purchasers. For instance:
  - The issuer's officers and directors cannot rely on the investment-only exemption.
  - A filing may be required when a passive investor who has relied on the investment-only exemption becomes an active investor or increases its holdings above 10 percent.

[1] A similar exemption for institutional investors (such as banks, savings and loan companies, insurance companies, investment companies, broker-dealers and certain trusts and nonprofits) is subject to essentially the same "passive intent" requirements, but allows for acquisitions up to 15 percent of the issuer's outstanding voting securities.

Recent News and Related Articles

- This recent Environmental practice group bulletin may be of interest to our readers doing business in Ohio, as it discusses recently revised guidance regarding determining Best Available Technology (BAT) for new and modified air permits: **Ohio EPA Issues Revised Air Permit Guidance**
- This article from our Labor & Employment group's quarterly newsletter focuses on having a clear policy for personal communication device usage at work: **BYOD: Balancing Employee Privacy Concerns Against Employer Security Needs**

For more details on any of the topics covered in this *Business Law Update*, please contact the authors via the links at the end of each article or David R. Valz, editor-in-chief. For information on our Corporate Transactions & Securities practice, please contact Frank D. Chaiken, practice group leader.

- The exemption does not apply if the purchaser intends to participate in the issuer's business decisions or in any way be involved in the issuer's management. The agencies may consider a party to have an intention of actively participating in an issuer's management even if the purchaser does not take any such actions until after the acquisition is complete.

- **Aggregation:** Purchasers should consider the aggregation rules even when acquiring small amounts of voting securities. For example, company executives exercising very small numbers of options or warrants with values well below the size of transaction threshold often fail a filing obligation because they forget to aggregate. In general, all voting securities of the issuer that will be held by the purchaser at the time of the acquisition must be considered when determining whether the size of transaction threshold has been crossed. Aggregation rules apply to acquisitions of assets and non-corporate interests as well.

- **Thresholds/five-year window:** Thresholds and time periods must be considered when additional voting securities of the same issuer are acquired. When an HSR notification is filed, the purchaser may continue to purchase shares up to the next threshold for five years. The purchaser must file again before it crosses the next-higher threshold.

- **First-time failures:** Parties must make a post-consummation filing, or corrective filing, as soon as they realize they consummated a reportable acquisition without filing the required notification and observing the appropriate waiting period under the HSR Act. The agencies often refrain from imposing civil penalties on parties making a corrective filing for the first time. In determining whether or not to take action on first time failures, the agencies may consider the following:

  - Whether the violation was the result of understandable or simple negligence.
  - Whether the corrective filing was made promptly after discovery of the violation.
  - Whether the parties realized any benefit that would not otherwise have been realized.
  - Whether the parties have implemented adequate measures to prevent future violations.

Some recent enforcement actions include:

MacAndrews & Forbes (2013)

MacAndrews & Forbes Holdings Inc. (M&F) paid a $720,000 civil penalty to settle charges that the company violated premerger reporting and waiting period requirements under the HSR Act when it acquired voting securities of Scientific Games Corporation.

M&F first made a corrective filing under the HSR Act in 2011. It had filed to report the acquisition of voting securities of SIGA Technologies, Inc. in 2010, but then continued to acquire additional voting securities of SIGA and failed to take into consideration the increased value of its total holding in SIGA shares. In May 2011, M&F filed a corrective filing to report the acquisition of additional voting securities valued at more than the next notification threshold. No civil penalty was imposed on M&F at that time.

Having learned its first lesson too late, M&F made a second corrective filing just one year later. In February 2007, M&F filed to report the acquisition of voting securities of Scientific Games Corporation. It was able to acquire additional voting securities for the next five years without being required to make an additional filing, but continued to acquire voting securities after the five-year period. M&F acquired an additional 800,000 shares of voting securities of Scientific Games Corporation valued at approximately $6.5 million. These shares, aggregated with the shares of voting securities of Scientific Games Corporation it already held, were valued at more than the size of transaction threshold in effect at the time. In August 2012, M&F again made a corrective filing under the HSR Act to report the acquisition of voting securities acquired after the end of the five-year period.

For a party in violation of the HSR Act, the maximum civil penalty is $16,000 a day. M&F was deemed to be in violation of the HSR Act from June 4, 2012 through September 17, 2012 and subject to a fine of well over $1 million; it eventually settled for a civil penalty of $720,000.

Barry Diller (2013)

Barry Diller paid a $480,000 civil penalty to settle charges that he violated premerger reporting and waiting requirements under the HSR Act when he acquired voting securities of The Coca Cola Company.

In 1998, Diller made a corrective filing for acquisitions of voting securities of CitySearch, Inc. made without filing and observing the waiting period under the HSR Act. The FTC refrained from imposing a civil penalty at that time, but

warned Diller that he was accountable for having an effective program to ensure full compliance with the requirements of the HSR Act.

Diller made a second corrective filing on May 23, 2013, which reported the acquisition of voting securities of Coke between November 1, 2010 and April 27, 2012. The HSR Act's "solely for the purpose of investment" exemption did not apply, as Diller intended to participate in the formulation, determination or direction of the basic business decisions of Coke through his membership on the board of directors. In this case, the FTC sought civil penalties against Diller, having previously warned him to put in place a program to prevent inadvertent failures to file.

Diller was deemed to be in violation of the HSR Act from November 1, 2010 through April 27, 2012 and could have been required to pay a fine of almost $9 million. He agreed to pay a civil penalty of $480,000 to settle these allegations.

Biglari Holdings, Inc. (2012)

Biglari Holdings, Inc. (Biglari) paid a $850,000 civil penalty to settle charges that it violated premerger reporting and waiting requirements under the HSR Act when it acquired voting securities of Cracker Barrel Old Country Store, Inc.

In May 2011, Biglari began acquiring voting securities of Cracker Barrel. It continued to purchase shares through June 13, 2011. By June 8, 2011, Biglari held voting securities of Cracker Barrel valued at more than the size of transaction threshold.

Biglari made an HSR filing on August 26, 2011. The FTC claimed that Biglari violated the HSR Act, as its intent was beyond what is permissible under the passive investment exemption. Biglari's CEO had talked with Cracker Barrel management and told them he had ideas to improve traffic at Cracker Barrel. He also had requested positions on Cracker Barrel's board of directors for two Biglari officers.

Biglari was deemed to be in violation of the HSR Act from June 8, 2011 through September 22, 2011 and could have been required to pay a fine of more than $1.5 million. It agreed to pay a penalty of $850,000 to settle these allegations.

For further information about the HSR Act and premerger reporting, contact Rachel G. Talay, Michael W. Jahnke or Barry M. Block.

Thompson Hine LLP has been recognized for the 11th year in a row as a leading law firm in the 2013 issue of* Chambers USA: America's Leading Lawyers for Business, *which ranks lawyers based on interviews with both clients and peers according to technical legal ability, professional conduct, customer service, commercial awareness, diligence and commitment.

Corporate group lawyers Thomas A. Aldrich, Frank D. Chaiken and David J. Willbrand were among those recognized.

Private Company

The Closely Held Business: To Squeeze or Not to Squeeze?

By Robin D. Powell and Anthony J. Rospert

Conflicts between the owners in closely held businesses are common and very disruptive. Indeed, the closely held corporation structure itself often leads to the abuse of minority shareholders. This is primarily due to the fact that owners of a closely held business are often its primary decision makers, but the backgrounds and qualifications of ownership in a closely held business rarely reflect the depth of knowledge and expertise that a large corporation's elected board of directors possess. Owners may include early investors, old friends, family members and/or longstanding employees, and frequently the owners are also the executives. As a consequence, the owner of a closely held business typically has more vested, personally and financially, than the traditional corporate decision maker.

Yet, the balance of decision-making authority in a closely held business commonly rests in the hands of a majority owner, or a few acting in concert, leaving those with a non-controlling interest – minority owners – subject to the discretion of the controlling majority. This results in *shareholder oppression,* which is rooted in several different legal theories, and more broadly addresses the evolving concern that majority shareholders in a corporation should not use their control to oppress a minority by employing mechanisms that disrupt the minority shareholders' reasonable expectation in the value of their shares.

Minority Shareholder Oppression

Minority shareholder oppression can take many forms. Two terms, *squeeze-out* and *freeze-out*, are often used interchangeably to describe the tactics most commonly employed by majority shareholders. These tactics may involve efforts by the majority to diminish the value of a minority shareholder's interest in the business. This can include terminating the minority shareholder's employment, voting the minority off the governing board, voting to divert resources to prevent dividends, and diverting resources toward the salaries and benefits of those shareholders still under the employ of the business. Controlling shareholders may also attempt to eliminate a minority shareholder's interest altogether, typically through mechanisms established by statute, such as dissolution and reacquisition of the business, reverse stock splits and cash-out mergers.

If these minority shareholder oppression issues arise, it is essential for both majority and minority owners to evaluate the risks and consequences of any action before taking it. Navigating the options requires an understanding of established common law and any governing statutes.

Common Law Remedies

Courts in many states impose a heightened fiduciary duty on majority shareholders. This duty owed to the minority by the controlling majority is similar to duties owed in a partnership or joint venture. A breach of this duty arises when the majority leverages control to its own advantage without providing the minority with the opportunity to benefit, absent a legitimate business purpose. Such a breach, in turn, gives rise to a cause of action by the individual minority shareholder. See, e.g. *Crosby v. Beam,* 47 Ohio St. 3d 105, 109 (Ohio 1989) (holding that majority shareholders have a fiduciary duty to minority shareholders, and noting that when majority shareholders in a closely held corporation utilize their majority control to their own advantage, without providing minority shareholders an equal opportunity to benefit, such breach, absent legitimate business purpose, is actionable). Filing suit against the majority under a breach of fiduciary duty theory is difficult, expensive and lacks certainty, but offers one option in combating oppressive conduct by majority shareholders.

Statutory Remedies

Many states have also developed a statutory right of appraisal for minority shareholders in a corporation in the event the majority employs a cash-out merger. See Ohio Revised Code Section 1701.85. The right of appraisal establishes a procedure by which courts can ensure a fair cash value is received for shares being forfeited by the minority shareholders. In the proper context, cash-out mergers still serve a valid purpose, and the right of appraisal functions as a step in the process. In the context of cases involving minority shareholder oppression, however, the right of appraisal can function as a shield against squeeze-

out or freeze-out tactics to protect the financial expectations of minority shareholders.

Some states preclude the right to challenge a cash-out merger through claims of minority shareholder oppression on the basis that the right of appraisal serves as a sufficient safeguard to protect minority shareholders in closely held businesses. Other states, such as Ohio, allow a minority shareholder to bring actions for both, albeit separately. See *Armstrong v. Marathon Oil Co.,* 32 Ohio St. 3d 397, 422 (Ohio 1987). Where actions for both can be brought, minority shareholders have an added advantage, while the possible consequences facing the majority are compounded.

Minority shareholders may also attempt to force a dissolution of the corporation through the courts, either as a tactic to bring the majority to the bargaining table or to force a liquidation. Generally, the courts perceive this as a drastic action and are hesitant to dissolve a corporation at the insistence of an unhappy minority shareholder. However, *some* state statutes, in following the Model Business Corporations Act, have expressly granted courts the authority to dissolve a corporation upon a finding of minority shareholder oppression. Compare Colorado Revised Statutes Section 7-114-301(2)(b) ("[a] corporation may be dissolved in a proceeding by a shareholder if it is established that . . . those in control of the corporation have acted, are acting, or will act in a manner that is illegal, oppressive, or fraudulent"), with Ohio Revised Code Section 1701.91(A) (not providing oppression as a means for dissolution). In states that provide the courts with this discretion, the relative position of majority shareholders to settle on favorable terms is further exposed.

Front-End Considerations

Proper planning is the best way to avoid lawsuits involving minority shareholder oppression issues. Owners can enter into a buy-sell agreement or employment contracts, and can implement call provisions, transfer restrictions or arbitration procedures, among others, in the organizing documents to help avoid conflicts that may lie ahead by determining what will happen if problems arise. Perhaps most importantly, proper planning will instill a sense of certainty and confidence that your closely held business will be prepared and protected. The best time to plan is before problems arise, because business owners can usually agree to reasonable terms when times are good.

If the time for planning has passed, no matter which side of the table you are on, the law can provide avenues intended to address and help navigate thorny squeeze-out or freeze-out situations. If you or your closely held company are facing these issues, or decisions that may give rise to them, you should consider consulting with counsel prior to taking any action that could jeopardize the company and/or your equity interests.

For more information on closely held businesses, please contact Robin D. Powell or Anthony J. Rospert.

Thompson Hine LLP is pleased to announce its inclusion in the 2013 edition of* The Legal 500 United States, *a directory of client- and peer-recommended firms, practices and lawyers used by clients throughout the country to guide their selection of lawyers and law firms. Published for more than 20 years, the Legal 500 series provides information and opinions about firms and lawyers across the globe based on interviews with lawyers and representatives from client companies.

Corporate group lawyers Frank D. Chaiken, John D. Cottingham, Tony Kuhel and Jonathon H. Vinocur were among those recognized.

Securities

Fifth Circuit Restricts Dodd-Frank Retaliation Protections for Whistleblowers

By Craig A. Foster

Note: This is an edited version of an article that ran in the December 2013 issue of *The Investment Lawyer*.

Let's say you have an employee with information relating to a potential securities law violation who reports it internally but not to the SEC. Would that employee lose the anti-retaliation protection provided under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank)? A line of district court decisions around the country have said no, holding that the provisions were ambiguous and *could* apply to individuals who report internally, rather than to the SEC.[1] However, in July of this year, the Fifth Circuit took a radically different position. In *Asadi v. G.E. Energy (USA), L.L.C.*,[2] the Fifth Circuit dismissed an anti-retaliation claim in which Khaled Asadi reported suspected wrongdoing to his supervisor, not the SEC, concluding that Asadi was not a "whistleblower" under the Securities Exchange Act of 1934, as amended (Exchange Act), because that definition required reporting to the SEC.

Here's a bit of background. In 2010, Dodd-Frank amended the Exchange Act to, among other things, direct the SEC to pay awards to whistleblowers who voluntarily provide the SEC with original information that leads to a successful SEC enforcement action in which more than $1 million is recovered. Awards under Dodd-Frank range from 10 to 30 percent of the total monetary sanctions recovered. Under the Exchange Act, a whistleblower is "any individual who provides, or 2 or more individuals acting jointly who provide, information relating to a violation of the securities laws to the Commission [SEC]" in a manner established by SEC rule. Retaliation by employers against employee whistleblowers is prohibited – the Exchange Act provides that employers may not take adverse action against an employee who (i) reported alleged wrongdoing to the SEC, (ii) assisted an SEC investigation or administrative action, or (iii) made certain internal disclosures required or protected by the Sarbanes-Oxley Act of 2002 (SOX). Whistleblowers who experience retaliation have the right under the Exchange Act to sue in district court for reinstatement, back pay and reasonable attorney fees.

Here's what happened in *Asadi*. In 2006, Asadi accepted an offer from G.E. Energy (USA), LLC (GE Energy) to serve as the company's Iraq Country Executive, and he relocated to Amman, Jordan. In 2010, while Asadi was serving in that capacity, Iraqi officials told him they believed GE Energy had hired a woman closely associated with a senior Iraqi official to curry favor with that official in negotiating a joint venture agreement. Asadi, concerned that the alleged conduct constituted a violation of the Foreign Corrupt Practices Act, reported the issue to his supervisor. He did not report the issue to the SEC. Not long after the internal report, Asadi received an adverse performance review, and GE Energy pressured him to step down from his role as Iraq Country Executive and accept a reduced role in the region. Asadi did not accept the lower role, and about one year after he made the internal report, GE Energy fired him.

Asadi filed a complaint in the U.S. District Court for the Southern District of Texas, alleging that GE Energy violated the anti-retaliation provisions of Dodd-Frank. The district court dismissed Asadi's claim, holding that the anti-retaliation provisions did not extend to extraterritorial whistleblowing activity. The district court declined, however, to decide whether Asadi qualified as a whistleblower entitled to any protections of the statute. When the case got to the Fifth Circuit, the court affirmed the dismissal, but on the grounds that Asadi did not qualify as a whistleblower.

Asadi acknowledged to the Fifth Circuit that he was not a whistleblower as defined in the Exchange Act because he did not report alleged wrongdoing to the SEC. Nevertheless, citing support from the prior decisions of the other courts and the SEC's regulatory definition of whistleblower, he argued to the Fifth Circuit that the statute should be construed to protect individuals like him whose actions fall

[1] *See, e.g., Kramer v. Trans-Lux Corp.,* 2012 WL 4444820 (D. Conn. Sept. 25, 2012); *Nollner v. S. Baptist Convention, Inc.*, 852 F.Supp.2d 986 (M.D. Tenn. 2012); *Egan v. TradingScreen, Inc.*, 2011 WL 1672066 (S.D.N.Y. May 4, 2011).

[2] *Asadi v. G.E. Energy (USA), L.L.C.*, 720 F.3d 620 (5th Cir. 2013).

within the third category of protected actions of persons who make internal disclosures to supervisors required under SOX, even if they do not report to the SEC.

The Fifth Circuit rejected his argument. The court reasoned that the plain language and structure of the whistleblower provision required a conclusion that "there is only one category of whistleblowers: individuals who provide information relating to a securities law violation to the SEC." The categories of protected conduct, according to the court, do not define which individuals qualify as whistleblowers. Instead, the court reasoned that the categories describe certain conduct which, if undertaken by an individual who is a whistleblower to begin with, is entitled to the protection of the anti-retaliation provisions.

Because the Fifth Circuit's decision limits those who might bring anti-retaliation claims, it may look like it favors employers. However, narrowing the scope of the definition of whistleblower may not be such good news for employers because employees may now be encouraged to dispense with internal reporting and go to the SEC directly with reports of alleged securities law violations. Without those internal reports, companies may not have the chance they otherwise would have to identify and correct suspected wrongdoing before a potential SEC investigation. Furthermore, the decision seems to undermine a key role of chief compliance officers, who, tasked with investigating and responding to instances of misconduct, may now find their jobs more difficult if employees are less willing to report violations internally.

The conflict between the Fifth Circuit and the various district courts illustrates that the law in this area is continuing to develop, and companies should by no means assume that an employee who reports internally will not be able to subsequently bring an anti-retaliation claim. And either way the law develops, companies should strive to build and maintain robust internal reporting and compliance programs that encourage employees to internally report suspected wrongdoing.

For more information about whistleblowers and retaliation claims, contact Craig A. Foster.

Ohio Super Lawyers Recognizes 98 Thompson Hine Lawyers

Ninety-eight lawyers from Thompson Hine LLP were recently selected for inclusion in *Ohio Super Lawyers®* and *Ohio Rising Stars* 2014. *Super Lawyers* magazine distinguishes the top 5 percent of attorneys in each state in more than 70 practice areas and recognizes those who have attained a high degree of peer recognition and professional achievement. Rising Stars are chosen by their peers as being among the most recognizable up-and-coming lawyers in Ohio.

Lawyers at the firm were also recognized for their high peer ratings, ranging from being among the top 100 in Ohio to the top 25 females in a region.

Succession Planning

Tips for Creating an Effective Succession Plan for Your Business

By Corby J. Baumann

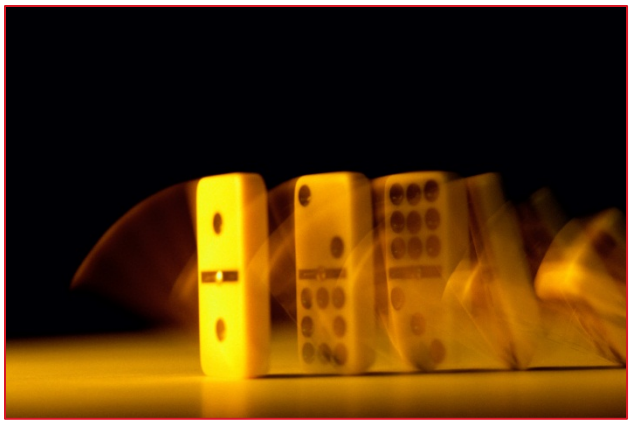
Many businesses do not have a succession plan in place. It is understandable that business owners would rather focus on operating and growing their businesses than planning for an unknown event – whether that event is the untimely death or disability of a member of the management team or the eventual retirement of the founder of the business.

There are significant reasons why a business owner should devote time to preparing a succession plan in advance of a succession event. For example, a succession plan allows the individuals involved in the business to discuss their plans for the business without the distraction and emotion that may be triggered by an actual succession event. A succession plan also provides a sense of security in that the management team has a plan in place and is not left feeling that they do not know how to handle the situation, which should make the transition easier to implement and less disruptive for the business.

Key considerations in creating an effective succession plan for your business include the following:

- **Information gathering.** As an initial matter, the management and owners of the business should start a conversation about each individual's expectations as to transitioning matters, including a review of each individual's retirement plan and goals for the business, as well as potential exit events for current business owners. Different individuals may have different ideas and expectations as to how they wish the business to operate currently and in the future, especially when thinking about all types of succession and transition events, including death, disability, divorce, retirement or a disagreement with respect to the operation of the business. Advanced planning and communication, including an understanding of each individual's plans and goals, are essential for preparing an effective succession plan.

- **Assessment of organizational needs.** A succession plan should be tailored to the particular needs of the business and its management. Management should plan to review the current size of the business and its anticipated growth as well as the impact a succession event may have on the current



customers, suppliers and lenders to the business. As part of this review, the roles and responsibilities of key employees should be identified and management should consider involving key employees in the process of identifying the potential needs of the business in a proposed transition. In addition, management should review any areas of operation that are dependent upon the efforts or know-how of one individual.

Key considerations in creating an effective succession plan for your business include the following:

- **Information gathering**
- **Assessment of organizational needs**
- **Personal succession matters**
- **Plan development**
- **Implementation**
- **Periodic plan review**

- **Personal succession matters.** Closely held or family-owned businesses will want to pay particular attention to personal succession planning matters. These matters may include the specific needs of the business owners or the family, including overall cash flow needs, each family member's interest in continuing in the business and each family member's plan for retirement. Additional concerns may include estate tax and personal exit strategies. To create an effective succession plan, other professionals who advise the business, including accountants, financial planners and insurance providers, should be involved when reviewing these personal succession matters.

- **Plan development.** While a succession plan need not describe every action and response, it is helpful to have a written framework for how transitional issues will be addressed. A succession plan should include the following:

  - A plan for communicating the transition of the business both internally and externally.
  - Procedures relating to record retention and record-keeping to ensure that critical business information is available in written form.
  - Procedures for ensuring adequate access to the assets and accounts of the business (for example, additional signatories may need to be added to the current bank accounts).
  - Procedures to ensure that more than one individual understands the finances of the business and is able to administer its policies.
  - An overview of the short-term and long-term objectives of the succession plan.
  - Any agreements or arrangements between the owners and/or employees of the business (for example, shareholders' agreements or buy/sell agreements).

- **Implementation.** After the succession plan has been developed, the existing organizational documents and lending arrangements of the business should be reviewed and updated to the extent necessary to reflect the succession plan (for example, determine whether the definition of change of control in the credit facility for the business refers to specific individuals). Buy/sell agreements may need to be entered into and/or "key man" insurance may need to be obtained. As part of implementing the succession plan, management should inform the advisors to the business and management team, including accountants, financial planners and insurance providers, about the adoption of the plan. In addition, management should consider informing certain key employees about the general terms of the plan.

- **Periodic plan review.** Once an appropriate succession plan has been implemented, it will need to be reviewed and reassessed periodically. At a minimum, management should plan to review the succession plan at least every two years. However, the review period should be carefully considered given the needs and situation of the specific business. For example, a business where the founder is nearing retirement age may wish to review its succession plan on a quarterly basis. Alternatively, if the business acquires another business or expands its operations into a new sector, the succession plan will need to be updated to reflect these changes in the overall operations and management team.

For more information about succession planning for your business, please contact Corby J. Baumann in Thompson Hine's New York office.

Private Equity

Private Equity Funds May Face ERISA Liability

By Edward C. Redder

A July 2013 decision from the U.S. Court of Appeals for the First Circuit – *Sun Capital Partners III LP v. New England Teamsters & Trucking Industry Pension Fund* – may have significant implications for private equity funds under ERISA. Specifically, the court adopted an expansive definition of "trade or business" for purposes of imposing liability on certain related companies for unfunded multiemployer pension plan obligations.

On November 21, 2013, the Sun Funds (defined below) petitioned the U.S. Supreme Court to review and reverse the Court of Appeals' decision. Given, however, the uncertainty over whether the U.S. Supreme Court will review the decision and, if so, whether it will reverse the decision, private equity funds are well advised to carefully review and evaluate their ownership interests in, and control of, the companies in which they invest.

Background

Under Title IV of ERISA, an employer that withdraws from participation in a multiemployer pension plan is liable for its proportionate share of the plan's vested but unfunded pension liabilities. For this purpose, an employer consists of all trades or businesses under common control. Common control exists among one or more trades or businesses if certain ownership levels are present. While the applicable regulations provide significant guidance in evaluating the ownership interests among companies, they do not address when a company constitutes a "*trade or business*."

The Sun Capital Case

In *Sun Capital*, the First Circuit Court of Appeals reversed the district court's grant of summary judgment in favor of defendants Sun Fund III and Sun Fund IV (Sun Funds), two Sun Capital investment funds advised by Sun Capital Advisors, Inc. The case involved an attempt by the New England Trucking Industry Pension Fund (Pension Fund) to hold the Sun Funds jointly and severally liable for the multiemployer pension withdrawal liability of Scott Brass, Inc., a portfolio company of the Sun Funds, on the theory that the Sun Funds had entered into a joint venture or partnership in common control with Scott Brass, Inc.

The district court granted summary judgment in the Sun Funds' favor on the grounds that they were mere investors and did not constitute trades or businesses. It also rejected the Pension Fund's argument that the Sun Funds' ownership structure should be disregarded as an attempt to evade and avoid liability under ERISA.

Rejecting the district court's grant of summary judgment in favor of the Sun Funds on the theory that they were mere passive investors, the First Circuit Court of Appeals instead applied an "investment plus" analysis, holding that an otherwise passive investment, when coupled with certain activities, could cause an investor to be a trade or business. Without giving specific guidelines as to what constitutes the "plus" part of the test, the court found that a private equity fund is a trade or business if it is engaged in an activity with respect to a portfolio company to make a profit, conducts that activity with continuity and regularity, and exercises significant control in the management and operation of the portfolio company.

Unresolved Issues & Takeaways

Notably, the court did not resolve whether Scott Brass and the Sun Funds were under common control, a complex determination left to the district court on remand. However, regardless of the outcome of the common control issue, *Sun Capital* serves as a cautionary tale for private equity funds and other organizations that have assumed they escape common control with their portfolio companies as a result of being "mere investors." Further, while *Sun Capital* addresses multiemployer pension plan obligations, the same considerations may extend to single-employer defined benefit plan termination liability because the same test for control group liability would apply.

As a result of the ruling – and pending any decision on appeal from the U.S. Supreme Court – private equity funds should reevaluate their methodologies for analyzing potential acquisition targets, and carefully consider how they structure their interests in those targets to mitigate these risks.

For more information on private equity funds and ERISA liability, contact Edward C. Redder.