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Hidden Employee Benefits Liabilities in Private Equity Portfolio Companies

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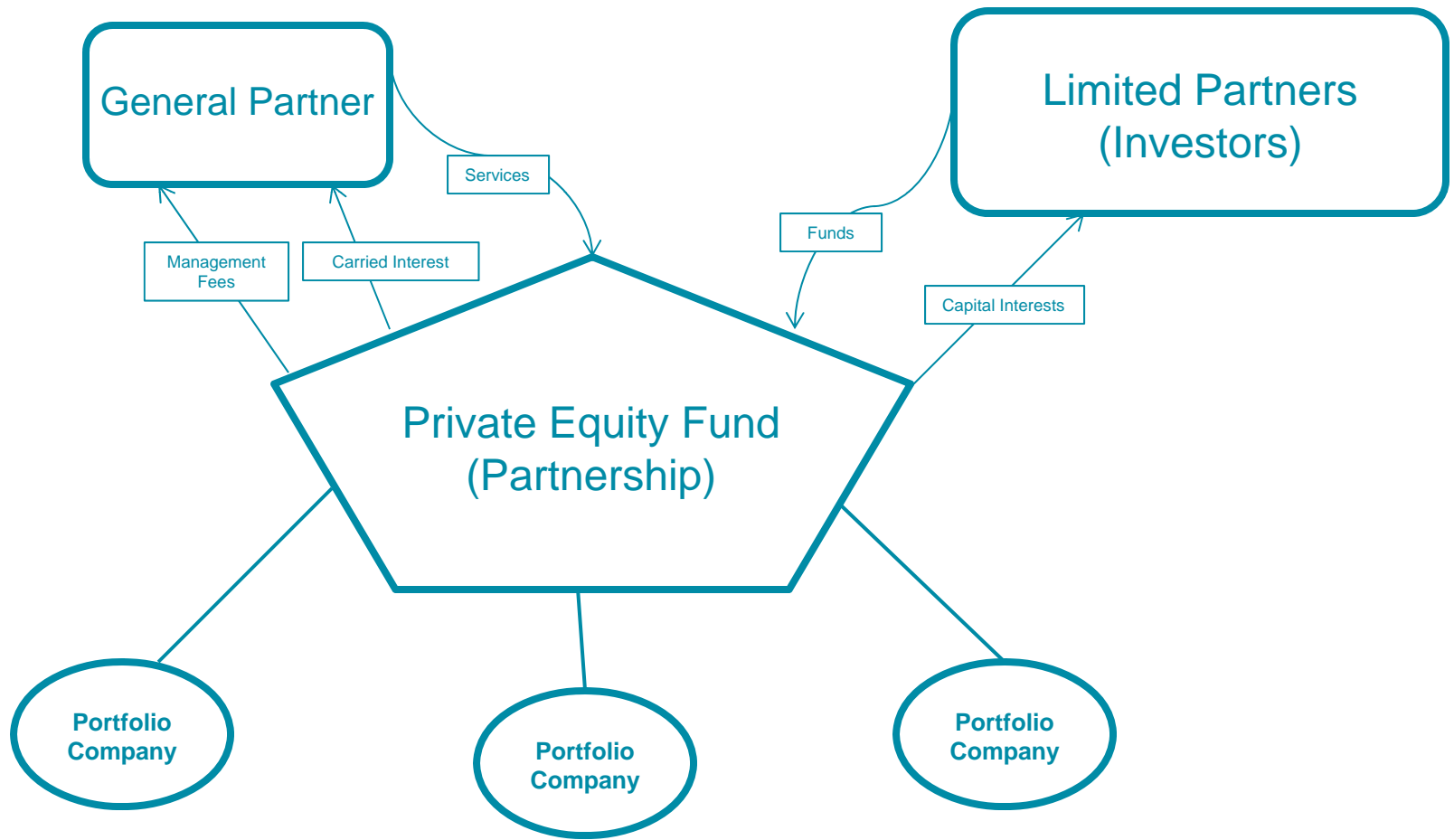
Introduction and Overview

- For a private equity fund, the employee benefit liabilities of any particular portfolio company may seem insignificant (relative to all of the fund's investments) and self-contained
- However, some types of employee benefit liabilities (principally those relating to pension plans and multiemployer plans) are “controlled group” liabilities for which each member of the controlled group is jointly and severally liable

Introduction and Overview

- If a private equity fund's ownership interest in its investments exceeds a threshold amount, there is a growing (and troubling) trend in favor of concluding that the fund and its portfolio companies could be part of the same controlled group for purposes of certain employee benefit liabilities
- The result is that the employee benefit liabilities of one portfolio company investment could spread to the fund and the fund's other portfolio company investments

Typical PE Fund Organization Structure



Controlled Group Determination

- Relationships and ownership/control thresholds
 - Ownership/control threshold required:
 - *Parent-subsidiary relationship – at least 80% ownership*
 - *Brother-sister relationship – five or fewer individuals with 80% overall ownership and 50% identical ownership*
 - “Trade or business” required: Corporations, partnerships, and/or other unincorporated entities

Controlled Group Determination

- Controlled group rules apply to an entity that constitutes a “trade or business”
- Investment fund’s status as a trade or business
- IRS rulings generally support a conclusion that an investment fund is not a trade or business
- In 2007, the Pension Benefit Guaranty Corporation (PBGC) issued a contrary opinion, concluding that a private equity fund was a trade or business jointly and severally liable for the unfunded benefit liabilities of one of its portfolio companies

Controlled Group Determination

- 2007 PBGC Opinion: Appeals or Advisory?
 - Advisory opinion concluded that an investment fund is a trade or business and, as such, the investment fund and its other related companies were part of the same controlled group
 - Advisory opinion is specific to a particular set of facts and circumstances and is not legally binding on other parties
 - Some question as to PBGC's authority to issue guidance that is arguably inconsistent with the IRS's position on related issues

Controlled Group Determination

- Current trend: A private equity fund could be a “trade or business” for purposes of controlled group determination
- The theories in the 2007 PBGC Opinion Letter have been judicially accepted in several recent cases involving private equity firms
- Other cases have held that passive investors outside the private equity context that meet the ownership-interest threshold could be considered “trades or businesses” under ERISA

Controlled Group Employee Benefit Plan Liabilities and Consequences

- Employee benefit plan liabilities that apply to all controlled group members
 - Single-employer defined-benefit pension plans
 - *FUNDING*
 - Multiemployer pension plans
 - *WITHDRAWAL LIABILITY*
 - Medical Plan COBRA liability
 - Other employee benefit plan liabilities through “alter ego” theories

Controlled Group Employee Benefit Plan Liabilities and Consequences

- Other indirect complications stemming from controlled group determinations and employee benefit plan liabilities
 - Loan covenants
 - Transaction reps and warranties
- Ongoing operational compliance concerns for certain employee benefit plans:
 - Coverage and nondiscrimination testing
 - Funding calculations and related restrictions
 - Excise tax determinations
 - Reporting

Managing Exposure with Morgan Lewis EB Practice

- The Morgan Lewis Employee Benefits Practice group has the substantive and industry experience to help identify and manage exposure to controlled group liabilities.
 - Transactional Expertise: We routinely advise clients on the benefits aspects of mergers, spin-offs, and divestitures, and have counseled clients in some of the country's largest corporate transactions.
 - Private Equity Industry Focus: We have a number of professionals with extensive experience counseling private equity funds in transactions.



Questions?

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Craig A. Bitman is a partner in, and deputy practice group leader of Morgan Lewis's Employee Benefits and Executive Compensation Practice. He is the Leader of Morgan Lewis's leading fiduciary practice and co-chair of its institutional investor practice. Mr. Bitman offers clients a broad range of knowledge and skills on all aspects of employee benefits and executive compensation law. He routinely advises public pension plans, companies, trust funds, and individuals with respect to matters involving qualified and nonqualified deferred compensation arrangements, severance plans, employment contracts, welfare benefit plans, equity-based compensation arrangements, mergers and acquisitions, plan investments, and fiduciary issues.

Mr. Bitman frequently writes and lectures on a host of topics affecting benefit plan sponsors and participants. He is a member of the National Association of Public Pension Attorneys and is admitted to practice in New York. Mr. Bitman has been named to *Best Lawyers*, and listed in *U.S. News and World Report's Best Lawyers* publication for the past four years. He has also been cited in *Legal 500* and in *PLC's Which Lawyer*.

In 1996, Mr. Bitman received his J.D., cum laude, from the Georgetown University Law Center where he was an editor of *The Tax Lawyer*. He earned his B.A. in economics from the University of Pennsylvania in 1993.

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Brian J. Dougherty is a partner in Morgan Lewis's Employee Benefits and Executive Compensation Practice and is the co-leader of the practice's Plan Sponsor Task Force. Mr. Dougherty's practice involves all aspects of employee benefits and ERISA, including compliance, plan design and administration, litigation, and executive compensation, including equity compensation, nonqualified arrangements, and employment agreements. He represents a number of large- and medium-sized clients in both for-profit and tax-exempt industries.

Mr. Dougherty has been named to *Chambers USA* (2011–2013), *Best Lawyers In America* (2005–2013), and *Pennsylvania Super Lawyers* (2004–2013). He is also a fellow in the American College of Employee Benefits Counsel and on the Board of Senior Editors for BNA's *Employee Benefits Law*.

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Amy Pocino Kelly is a partner in Morgan Lewis's Employee Benefits and Executive Compensation Practice. Ms. Kelly's practice focuses on all aspects of the firm's employee benefits practice. She advises plan sponsors of all types, including public and private companies, tax exempt organizations, and governmental employers regarding design, governance, operation, and compliance of qualified and non-qualified retirement plans, equity and executive compensation arrangements, and welfare benefit plans. Ms. Kelly also advises plan sponsors with respect to audit and correction matters before the Internal Revenue Service and the Department of Labor.

In addition, Ms. Kelly regularly advises public and private companies of all sizes regarding employee benefits issues in mergers and acquisitions, with a focus on the executive compensation matters for key management, including the design and implementation of retention agreements, and analysis of the application of sections 280G and 409A of the Internal Revenue Code. She has also represented several senior management teams in leveraged buyout transactions.

Ms. Kelly is actively involved in the firm's recruiting efforts and serves as a member of the Philadelphia office Recruiting Committee and summer associate mentor. Ms. Kelly also spends significant hours dedicated to pro bono representations. Ms. Kelly serves as a member of the Board of Directors of both Robins' Nest, Inc. and Women Against Abuse.

Ms. Kelly received her J.D. from Rutgers University School of Law in 1999 and her B.A. from Boston University in 1996. Ms. Kelly is admitted to practice in Pennsylvania, the District of Columbia, and Virginia.

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