BNA Insights

Sun Capital and Defining a 'Trade or Business' Under ERISA: The Odyssey Continues

By Lewis Cohn

Rarely does the U.S. Supreme Court's denial of a petition of certiorari have seismic repercussions for either the parties involved or the legal community in general. For the parties, the denial of certiorari merely confirms the result of the most-immediate prior proceeding. For the remainder of the legal community, a denial of certiorari generally carries no consequences.

The denial of plaintiffs' petition for certiorari in *Sun Capital Partners III, LP v. New England Teamsters & Trucking Indus. Pension Fund*,[1] on one hand, meets these regular expectations. On the other hand, the failure or reluctance of the Supreme Court to consider the issues raised in this appeal may have consequences that transcend the interests of the immediate parties.

Not the least of these considerations is the failure of the High Court to define the "trade or business" element of the test to impose statutory withdrawal liability on controlled group individuals and entities under the Employee Retirement Income Security Act ("ERISA")[2] and the Multiemployer Pension Plan Amendments Act ("MPPAA").[3] Equally important, the denial of certiorari in the *Sun Capital* appeal withheld needed direction on a series of subordinate issues that have divided both the Circuit and District Courts that have weighed in on the imposition of withdrawal liability.

This article shall explore the legal bases on which the *Sun Capital* decisions were rendered and the basic principles of withdrawal liability on which the decisions turned. As the legal fulcrum for these decisions, the article will discuss the manner in which courts have resolved whether particular controlled group members have satisfied the "trade or business" requirement of the withdrawal liability test. Finally, the article will consider the issues that remain—and that were left unresolved by the Supreme Court's denial of certiorari—to arrive at a consistent definition of what constitutes a "trade or business" under ERISA and MPPAA.

[1] *Sun Capital Partners III, LP v. New England Teamsters & Trucking Indus. Pension Fund*, 903 F. Supp.2d 107, 54 EBC 1161 (D. Mass. 2012) (203 PBD, 10/22/12; 39 BPR 2016, 10/23/12); *aff'd in part & rev'd in part*, 724 F.3d 129, 56 EBC 1139 (1st Cir. 2013) (143 PBD, 7/25/13; 40 BPR 1852, 7/30/13); *cert. denied*, 2014 BL 57911 (March 3, 2014) (42 PBD, 3/4/14; 41 BPR 573, 3/11/14).

[2] 29 U.S.C. §§ 1001-1361.

[3] 29 U.S.C. §§ 1381-1461.

Lewis Cohn (lcohn@wsmesq.com) is a partner at Witman Stadtmauer, P.A. in Florham Park, N.J. He specializes in commercial litigation, including employee benefits claims under ERISA and the MPPAA.

Basic Principles

While the issue presented on appeal by the *Sun Capital* case—whether a private equity fund was a "trade or business" for the purpose of imposing withdrawal liability on investors in the fund—represented a novel legal question within unique factual circumstances, the resolution of the case ultimately turned on basic principles of law under ERISA and MPPAA. It may be for precisely this reason that the denial of certiorari by the Supreme Court may have been a forgone conclusion.

The trick to understanding the *Sun Capital* case, however, may not reside in the basic principles themselves as it does on which basic principles are applied and how they are applied by the courts. This requires an appreciation of not only the "trade or business" requirement of ERISA, but also of the divergent approaches that courts have adopted in determining whether particular members of a controlled group fit within the definition of a "trade or business" for the purpose of imposing withdrawal liability on those controlled group members.

The concept of withdrawal liability was introduced by the enactment of ERISA in 1974. As articulated by the courts, the purpose of withdrawal liability was "to prevent the 'great personal tragedy' suffered by employees whose vested benefits are not paid when pension plans are terminated."[4]

Unfortunately, structural defects in ERISA's original legislation provided a veritable incentive for employers to withdraw from underfunded and failing multiemployer pension plans.[5] Spurred by concerns voiced by the Pension Benefit Guaranty Corporation ("PBGC")—which functions as a quasi-Federal Deposit Insurance Corporation for pension funds—that federal funds available under ERISA to pay benefits due from underfunded pension plans would be exhausted by claims from such plans, Congress enacted MPPAA to address the burgeoning pension crisis.[6]

To plug the drain on federal funds by such claims, MPPAA imposes absolute liability not only on with-

[4] *Nachman Corp. v. Pension Benefit Guaranty Corp.*, 446 U.S. 359, 374, 2 EBC 1431 (1980).

[5] *Robbins v. Admiral Merchants Motor Freight, Inc.*, 846 F.2d 1054, 1055-1056, 9 EBC 2282 (7th Cir. 1988).

[6] *McDougall v. Pioneer Ranch Ltd. Partnership*, 494 F.3d 571, 574, 41 EBC 1001 (7th Cir. 2007) (134 PBD, 7/13/07; 34 BPR 1696, 7/17/07); *cert. den.*, 552 U.S. 1098, 42 EBC 2472 (2008) (4 PBD, 1/8/08; 35 BPR 137, 1/15/08).

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drawing employers but also on members of the employers' so-called controlled groups, i.e., other entities or individuals affiliated with a withdrawing employer by common ownership.[7] When an employer withdraws from a multiemployer pension plan, both the employer and the members of its controlled group incur joint and several liability from the date of withdrawal from the plan for a proportionate share of the plan's total unfunded vested liability.[8]

As amended by MPPAA, ERISA generally imposes two requirements to extend withdrawal liability to members of a controlled group from the withdrawing employer who originally incurred such liability. First, a member of the controlled group must be shown to be under "common control" with the withdrawing employer.[9] The concept of "common control" has been equated with more than an 80 percent common ownership between a withdrawing employer and a controlled group member.[10] Because of the mechanistic manner in which this mathematical test is applied[11]—with certain limited exceptions—most cases involving the imposition of withdrawal liability do not turn on whether an alleged controlled group member is or is not under "common control" with a withdrawing employer. Simply put, there is either a well-defined 80 percent common ownership between the alleged member and the withdrawing employer or there is not.

The second requirement to imposing withdrawal liability on a member of a controlled group is that the member be a "trade or business"—the precise issue that was before the courts in the *Sun Capital* case. Neither ERISA, nor MPPAA, however, provides any definition of the phrase, "trade or business."[12] Instead, Section § 4001(b)(1) [29 U.S.C. § 1301(b)(1)] of ERISA prescribes that regulations adopted in accordance with the statutory scheme shall be "consistent and co-extensive with regulations prescribed for similar purposes by the Secretary of the Treasury under § 414(c) of Title 26 [26 U.S.C. § 414(c)]."[13] This injunction, however, provides no direction as Section 414(c) of the Internal Revenue Code provides no definition of "trade or business"; neither do the regulations by the Secretary of the Treasury pursuant to Section 414(c).[14] Thus, in one of the earliest cases to construe the meaning of "trade or business," the District Court lamented that the phrase has "not been defined by either the [Internal Revenue] Code or the Treasury regulations, nor has any authoritative judicial definition of the terms evolved."[15]

The Ad Hoc Test

In the absence of a controlling definition of "trade or business," courts initially imposed withdrawal liability based on a series of ad hoc considerations during the first decade after the enactment of MPPAA. Recognizing that "the meaning of 'trade or business' is slippery,"[16] the courts construing the phrase attempted to divine its meaning by looking "to the purpose of ERISA for how 'trade or business' should be interpreted."[17] Among the statutory purposes articulated by the courts to be served through a particular definition of "trade or business" included the frustration of efforts by corporations to insulate virtually all of their assets from ERISA liability,[18] to prevent businesses from juggling their activities to eviscerate the termination liability provisions of ERISA,[19] as well as the more general and historical purpose of preventing companies from limiting their responsibilities under ERISA by fractionalizing their business operations.[20]

Equally diverse were the factual circumstances that moved courts to either find or reject the operations of certain businesses as "trades or businesses." Among such considerations were the provision of financing by the owner of a withdrawing employer to a controlled group entity,[21] the "symbiotic relationship" that existed between the withdrawing employer and a member of its controlled group,[22] and, in multiple cases, the leasing of property by a controlled group member to a withdrawing employer.[23] The absence of defining principles and the need for something to unify the rapidly divergent approaches adopted by courts under the ad hoc test required some other basis upon which to determine what constituted a "trade or business."

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[7] *Pension Benefit Guaranty Corp. v. R.A. Gray & Co.*, 467 U.S. 717, 723, 5 EBC 1545 (1984)

[8] 29 U.S.C. § 1381. An "unfunded vested liability" is defined as the difference between the actuarial present value of the vested benefit obligations and the value of a plan's assets. *Shelter Framing Corp. v. Pension Benefit Guaranty Corp.*, 705 F.2d 1502, 1505, 4 EBC 1429 (9th Cir. 1983).

[9] 29 U.S.C. § 1301(b)(1).

[10] 26 C.F.R. § 1.414(c)-2(b)(2)(i)(A), (c)(1)(i).

[11] See "The Controlled Group Rule for Purposes of the Withdrawal Liability Provisions of the Employee Retirement Income Security Act," 90 *W.Va.L.Rev.* 773 (1988).

[12] 29 U.S.C. § 1301(b)(1); *Vaughn v. Sexton*, 975 F.2d 498, 502 (8th Cir. 1992); *United Food & Commercial Workers Union v. Progressive Supermarkets*, 644 F. Supp. 633, 637, 7 EBC 2165 (D.N.J. 1986).

[13] 29 U.S.C. § 1301(b)(1).

[14] See 26 C.F.R. §§ 1.414(c)-1—1.414(c)-4)

[15] *United Food & Commercial Workers Union v. Progressive Supermarkets, supra*, 644 F. Supp. at 637, *quoting from, Groetzinger v. Commissioner of Internal Revenue Service*, 771 F.2d 269, 271 (7th Cir. 1985).

[16] *Teamsters Pension Trust Fund v. Malone Realty Co.*, 82 B.R. 346, 350 (E.D.Pa. 1988).

[17] *Central States, Southeast & Southwest Areas Pension Fund v. Lloyd L. Sztanyo Trust*, 693 F. Supp. 531, 536 (E.D.Mich. 1988)

[18] *Teamsters Pension Trust Fund v. Malone Realty Co., supra*, 82 B.R. at 350.

[19] *Pension Benefits Guaranty Corp. v. Ouimet Corp.*, 470 F. Supp. 945, 955 (D.Mass. 1979)

[20] *Board of Trustees v. H.F. Johnson, Inc.*, 830 F.2d 1009, 1013 [8 EBC 2593] (9th Cir. 1987); *Pension Benefit Guaranty Corp. v. Center City Motors, Inc.*, 609 F. Supp. 409, 412 [6 EBC 2058] (S.D. Cal. 1984).

[21] *Pension Benefit Guaranty Corp. v. Center City Motors, Inc., supra* (" . . . Mr. Swink used his position as an automobile dealer to obtain permanent financing for the development of the property, that his selection of the property was accomplished with the aid of corporate resources, and that his purchase and development of the property was simply a part of an overall plan for the operation of his business of operating an automobile dealership." 609 F. Supp. at 412-413).

[22] *Teamsters Pension Trust Fund v. Malone Realty Co., supra*, 82 B.R. at 350.

[23] *United Food & Commercial Workers Union v. Progressive Supermarkets, supra*; *Central States, Southeast & Southwest Areas Pension Fund v. Skyland Leasing Co.*, 691 Supp. 6 (W.D.Mich. 1987), *aff'd*, 892 F.2d 1043 (6th Cir. 1990).

The *Groetzinger* Test

In 1987, the U.S. Supreme Court issued its decision in *Commissioner of Internal Revenue v. Groetzinger*.[24] At issue in *Groetzinger* was the taxability of a professional gambler's winnings as income. Although the applicable stature imposed only a preferential minimum tax on taxpayers, the deductions available to a taxpayer did not include deductions attributable to a "trade or business."[25] Thus, the Supreme Court was ultimately asked to articulate a test to determine if the gambler's activities constituted a "trade or business."

In his opinion for the Court, Justice Harry Blackmun found himself traveling the same uncharted waters in reaching a definition of "trade or business" under the tax code that courts had already confronted in construing the same phrase under ERISA and MPPAA. As Justice Blackmun stated, the task of determining what was and was not a "trade or business" "has not been ameliorated by the persistent absence of an all-purpose definition, by statute or regulation, of the phrase "trade or business" which so frequently appears in the Code."[26] The frequency with which the phrase appears in the tax code,[27] and the diverse contexts in which the phase was utilized, ultimately impelled the Court to reject past judicial efforts to define "trade or business."[28]

Ultimately, the Supreme Court opted to articulate its own definition of what constituted a "trade or business." In this regard, Justice Blackmun stated:

> We accept the fact that to be engaged in a trade or business, the taxpayer must be involved in the activity with continuity and regularity and that the taxpayer's primary purpose for engaging in the activity must be for income or profit. A sporadic activity, a hobby, or an amusement diversion does not qualify.[29]

The so-called *Groetzinger* test enunciated by the Supreme Court, thus, had two basis elements: (1) whether the taxpayer engaged in an activity for the primary purpose of income or profit; and (2) whether the taxpayer engaged in the activity with continuity and regularity.[30]

At the outset, the *Groetzinger* test adopted by the Supreme Court seemed to have little relevance for determining issues of withdrawal liability. *Groetzinger* considered the issue of what was a "trade or business" under the tax code as opposed to ERISA and MPPAA. The factual genesis for the *Groetzinger* decision was a tax controversy, not a withdrawal liability dispute. Unlike the situation in withdrawal liability cases in which liability is being extended to persons or entities beyond the original withdrawing employer, *Groetzinger* was concerned with whether a single and primarily-liable defendant was a "trade or business."

It was therefore not surprising that, for a number of years after the *Groetzinger* case was decided, courts continued to use the ad hoc approach to decide withdrawal liability matters.[31] Even after courts began to apply the *Groetzinger* test within these cases, the courts did so while retaining the ad hoc considerations that had previously dominated the courts' analyses.[32] Nonetheless, since the mid-1990's, the *Groetzinger* test has emerged as the predominant—though not the exclusive[33]—statement of what constitutes a "trade or business."[34]

The attractiveness of the *Groetzinger* test was not difficult to understand. In the first instance, the *Groetzinger* test commanded respect simply because it was

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[24] 480 U.S. 23 (1987).

[25] 26 U.S.C § 57(a)(1) & 57(b)(1)(A).

[26] 480 U.S. at 33.

[27] By one court's estimation, the phrase "trade or business" appears approximately in over 50 sections and over 800 subsections of the tax code. *ILGWU Nat'l Retirement Fund v. Minotola Indus., Inc.* (S.D.N.Y. May 3, 1991).

[28] "A test that everyone passes is not a test for all." 480 U.S. at 34.

[29] 480 U.S. at 35.

[30] 480 U.S. at 35; *Central States, Southeast & Southwest Areas Pension Fund v. Neiman*, 285 F.3d 587, 594 [27 EBC 2173] (7th Cir. 2002)(65 PBD, 4/4/02; 29 BPR 1151, 4/9/02); *Connors v. Incoal, Inc.*, 995 F.2d 245, 251 [16 EBC 2553] (D.C.Cir. 1993).

[31] *Central States, Southeast & Southwest Areas Pension Fund v. Slotky*, 956 F.2d 1369 [14 EBC 2753] (7th Cir. 1992); *Vaughn v. Sexton, supra.*

[32] *NYSA-ILA Pension Trust Fund v. Lykes Bros., Inc., Inc.* (S.D.N.Y. Aug. 6, 1997) ("Beyond this articulation of the test in *Groetzinger*, it is useful to look to the purpose of ERISA and the MPPAA."), *Connors v. Incoal, Inc., supra* (Court cites to *Groetzinger* but notes that "courts have adopted a case-by-case approach to determine whether an entity constitutes a 'trade or business' under ERISA." 781 F. Supp. at 54); *Trustees of Plumbers & Pipefitters Nat'l Pension Fund v. Mar-Len, Inc.*, 864 F. Supp. 599 (E.D. Tex., 1994) (Although court finds that the *Groetzinger* test "best qualifies the phrase 'trade or business' ", "the court does not strictly adhere to this definition and includes the goals of ERISA and the MPPAA as factors in determining liability." 864 F. Supp. at 608);

[33] A minority of jurisdictions—including, most notably, the Ninth Circuit and the Northern District of California—have rejected the *Groetzinger* test in favor of the ad hoc approach. *See, Board of Trustees Western Conference of Teamsters v. Lafrenz*, 837 F.2d 892, 894 [9 EBC 1533] (9th Cir. 1988); *Carpenters Pension Trust Fund v. Lindquist*, 2011 BL 188151 [52 EBC 1252] (N.D.Ca. 2011)(140 PBD, 7/21/11; 38 BPR 1394, 7/26/11), *aff'd*, 491 Fed. Appx. 830, 2012 BL 304961 (9th Cir. 2012).

[34] *Central States, Southeast & Southwest Areas Pension Fund, v. Neiman, supra*, 285 F.3d at 594; *Central States, Southeast & Southwest Pension Fund, v. Personnel, Inc.*, 974 F.2d 789, 794 [15 EBC 2184] (7th Cir. 1992); *Board of Trustees v. Del. Valley Sign Corp.*, 945 F. Supp. 2d 649, 654-655 [56 EBC 1533] (E.D. Va. 2013)(94 PBD, 5/15/13; 40 BPR 1256, 5/21/13); *Central States Southeast & Southwest Areas Pension Fund v. Cargo Carriers, Inc.*, 2013 BL 193477 (M.D.N.C. 2013); *Board of Trustees v. Joyce Ford, Inc.*, 2013 BL 165128 [55 EBC 2751] (N.D.Ill. 2013)(122 PBD, 6/25/13; 40 BPR 1604, 7/2/13); *UCFW Local One Pension Fund v. 15 McFadden Road, Inc.*, 2013 BL 212232 [57 EBC 1543] (N.D.N.Y. 2013)(159 PBD, 8/16/13; 40 BPR 2012, 8/20/13); *Central States, Southeast & Southwest Areas Pension Fund v. Ray C. Hughes, Inc.*, 2012 BL 114096 [53 EBC 2805] (N.D.Ill., 2012)(84 PBD, 5/2/12; 39 BPR 909, 5/8/12); *Board of Trustees, Sheet Metal Workers' Nat'l Pension Fund v. Palladium Equity Partners II-A, L.P.*, 722 F. Supp.2d 854, 867 (E.D.Mich. 2010); *Central States, Southeast & Southwest Areas Pension Fund v. SCOFBP, LLC*, 738 F. Supp.2d 840, 847 (N.D.Ill. 2010), *aff'd*, 668 F.3d 873, 878 (7th Cir. 2011), *cert. den.*, ___ U.S. ___, 132 S.Ct. 2688, 183 L.Ed.2d 46 (2012); *Harrell v. Eller Maritime Co.*, 2010 BL 230597 (M.D.Fl. 2010); *Plumbers & Steamfitters Local No. 150 Pension Fund v. Custom Mech. CSRA, LLC*, 2009 BL 263178 (S.D.Ga. 2009); *The Nat'l Pension Plan of the Unite Here Workers Pension Fund v. Swan Finishing Co., Inc*, 2006 BL 60897 [37 EBC 2609] (S.D.N.Y. 2006)(33 PBD, 2/17/06; 33 BPR 569, 2/28/06); *Chicago Truck Drivers, Helpers & Warehouse Workers Union Pension Fund v. Kelly* (N.D.Ill. Sept. 9, 1996); *Central States, Southeast & Southwest Areas Pension Fund v. Miller*, 868 F. Supp. 995 (N.D.Ill. 1994); *ILGWU Nat'l Retirement Fund, v. Minotola Indus., Inc., supra.*

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rendered by the highest court in the country. The fact that the case arose under the Tax Code—as opposed to ERISA or MPPAA—was similarly attractive because of ERISA's historic directive that regulations adopted to implement the statutory purpose should be "consistent and co-extensive with regulations prescribed for similar purposes by the Secretary of the Treasury under § 414(c) of Title 26," i.e., the Tax Code.[35] The two-pronged standard that the Supreme Court articulated was readily understandable and equally easy to apply. Indeed, the malleable nature of the *Groetzinger* test permitted courts to render decisions that were consistent with, and did not necessarily require the overthrow of, decisions that had been reached under the prior ad hoc test.[36]

Yet, even with the analytical armature provided by the *Groetzinger* test, there was an inconsistent judicial reaction to the manner in which it was applied. For example, the District Courts comprising the Seventh Circuit—a hotbed of withdrawal liability litigation—took the lead of the Court of Appeals and focused on the first prong of the *Groetzinger* test (i.e., whether the primary purpose of a member of a controlled group was income or profit) almost to the exclusion of the second prong (i.e., whether the controlled group member engaged in an activity with continuity and regularity).[37] In this regard, the Seventh Circuit stated:

> Because formal business organizations ordinarily operate with continuity and regularity and are ordinarily formed for the primary purpose of income or profit, it seems highly unlikely that a formal for-profit business organization would not qualify as a 'trade or business' under the *Groetzinger* test.[38]

It was as a result of a search for a more even-handed approach that the passive investment test was spawned.

The Passive Investment Test

Contrary to what is implied by its name, the passive investment test does not constitute a separate set of standards articulated by the courts in opposition to the *Groetzinger* test. Indeed, most courts applying the passive investment test profess a continued adherence to the *Groetzinger* test.[39] Rather, the passive investment test represents a judicial adjustment in emphasis in the manner in which the *Groetzinger* test is applied.

The evolution of a passive investment test has not been easy. In one of the earliest considerations of this new approach, the Ninth Circuit, in *Board of Trustees of the Western Conference of Teamsters Pension Trust Fund v. Lafrenz*,[40] rejected defendants' assertion that their unincorporated leasing operation of two dump trucks represented a passive investment. On one hand, the court found that a passive investment was not recognized by the statutory language of ERISA:

> This argument fails because the statute does not distinguish between active and passive investments.[41]

On the other hand, the Ninth Circuit did not foreclose the possibility that a business might be exempted from withdrawal liability as a passive investment. The court limited the reach of its holding by observing in a footnote:

> We do not hold that every 'passive investment' is necessarily a trade or business. We hold only that the facts in this case justify the conclusion that the truck-leasing operation is a trade or business.[42]

These inauspicious beginnings notwithstanding, the passive investment test reached its analytical zenith in 2001 in *Central States, Southeast & Southwest Areas Pension Fund v. Fulkerson*[43] and *Central States, Southeast & Southwest Areas Pension Fund v. White*.[44] Ironically, *Fulkerson* and *White* were both issued by panels of the Seventh Circuit, one of the earliest and most staunch adherents to the *Groetzinger* test.

In *Fulkerson*, the courts considered the leasing operations of Tom Fulkerson, whose trucking firm—owned 100 percent by Fulkerson and his wife—had withdrawn from the pension plan. Prior to its withdrawal from the plan, Fulkerson's company had financed the acquisition of several properties and the construction of trucking terminals on the properties. These developed properties were subsequently sold to Fulkerson who thereafter leased the properties to third-parties.

After the trial court held Fulkerson liable as an unincorporated trade or business for his trucking firm's withdrawal liability, the Seventh Circuit reversed. Although purporting to follow the *Groetzinger* test, the Court set forth a tripartite analysis for what it found to be Fulkerson's passive investment activities.

First, the Seventh Circuit cautioned that ERISA "was not intended to impose automatic personal liability on individuals who own companies that are required to contribute to pension funds."[45] Second, the Court stated the proposition that "mere ownership of a property (as opposed to activities taken with regard to the property) cannot be considered in determining whether conduct is regular or continuous"—a litmus test for withdrawal liability.[46] Finally, in assessing Fulkerson's activities with respect to the leased properties—virtually all of which were triple-net leases by which the tenants were responsible for most of the properties' financial obligations—the Court found that the defendant

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[35] *See*, footnote 13, *supra*.

[36] Indeed, certain courts appeared to meld the *Groetzinger* test with the prior ad hoc test in an almost seamless fashion. *See, Trustees of the Plumbers and Pipefitters Nat'l Pension Fund . Mar-Len, Inc., supra*, (While stating that the *Groetzinger* test "best qualifies" the phrase, "trade or business," the District Court observed that it "does not strictly adhere to this [the *Groetzinger*] definition and includes the goals of ERISA and the MPPAA as factors in determining liability." 864 F. Supp. at 608, n.4.

[37] A relatively recent illustration of this one-side application of the *Groetzinger* test is *Central States, Southeast & Southwest Areas Pension Fund v. Ray C. Hughes, Inc., supra*.

[38] *Central States, Southeast & Southwest Areas Pension Fund v. SCOFBP, LLC., supra*, 668 F.3d at 878.

[39] *Government Dev. Bank v. Holt Marine Terminal*, 765 F. Supp.2d 710, 715 [50 EBC 2720] (E.D.Pa. 2011)(60 PBD, 3/29/11; 38 BPR 701, 4/5/11).

[40] *See*, footnote 33, *supra*.

[41] 837 F.2d at 894

[42] 837 F.2d at 894, n.7

[43] 238 F.3d 891 [25 EBC 1842] (7th Cir. 2001)(21 PBD, 1/31/01; 28 BPR 608, 2/6/01), *rehearing en banc den., cert. den.*, 534 U.S. 821 [26 EBC 2919] (2001)(185 PBD, 10/2/01; 28 BPR 2471, 10/2/01).

[44] 258 F.3d 636 [26 EBC 1705] (7th Cir. 2001)(137 PBD, 7/23/01; 28 BPR 1898, 7/24/01)

[45] 238 F.3d at 896.

[46] 238 F.3d at 895-896

never spent more than five hours annually in administering either the leases or the leased properties.[47] Based on these findings, the Seventh Circuit concluded that Fulkerson's leasing activities did not amount to a statutory "trade or business."

Several months after issuing its decision in *Fulkerson*, the Seventh Circuit again applied the passive investment test in *White*. After the trucking firm owned by the defendants-husband and wife withdrew from the pension plan, the plan sought to extend withdrawal liability to the defendants based on income that they realized from renting apartments located above a garage at their home.

In reversing a summary judgment granted to plaintiff by the District Court, the Seventh Circuit grounded its decision on three overarching considerations. First, as in *Fulkerson*, the Seventh Circuit found that the defendants' leasing activities entailed little or no personal effort aside "from the normal maintenance and upkeep that every homeowner performs."[48] Second, in distinguishing the defendants' leasing activities from a substantial number of cases in which lessors were deemed to have been engaged in a "trade or business," the Seventh Circuit found that defendants' interest in deriving income or profit from the rental of the apartment was secondary to providing an element of security for the defendant-wife while her husband was away on frequent business trips.[49]

Finally, as almost a visceral reaction to the disparity between the limited income that the defendants realized from their leasing activities and the approximately $16 million in withdrawal liability that they faced, the Court found the imposition of liability to be inconsistent with the statutory purposes of ERISA. As the Seventh Circuit concluded:

> A law with the sound purpose of preventing fractionalization should not be stretched to such an extreme application that would expose a common owner of a completely unrelated personal business to such withdrawal liability. The Whites' [defendants'] two apartments did not offend Congress' purpose designed to prevent businesses from shirking their ERISA obligations.[50]

The promise that the passive investment test offered as a counterpoint to the *Groetzinger* test has not, however, been realized in the more than a decade that has followed the *Fulkerson* and *White* decisions. On one hand, the passive investment test highlighted the concern of the *Groetzinger* test with distinguishing what was a trade or business from "[a] sporadic activity, a hobby, or an amusement diversion."[51] On the other hand, an exploration of a defendant's subjective intentions in engaging in a particular activity to determine if his involvement was truly passive conflicted with a series of decisions arising under Section 1301(b)(1) [in which the "trade or business" requirement is set forth] of ERISA which have disavowed any need to ascertain an investor's actual purpose.[52]

As a result, even where trial courts have endorsed the passive investment test in recent years, the victories gained by defendants were short-lived and were often reversed on appeal.[53] The most recent in this trend of reversals of the passive investment test was rendered by the First Circuit Court of Appeals in the *Sun Capital* case.

Sun Capital and the Investment-Plus Test

On its surface, the *Sun Capital* case appeared poised as a classic confrontation of the continued viability of the passive investment test in juxtaposition to the more-accepted *Groetzinger* test. Unlike other more conventional commercial ventures that had previously been deemed "trades or businesses" by the courts, plaintiffs' participation in an equity holding venture certainly had the "feel" of an investment vehicle. Instead of resolving the competing standards of these two legal tests, the First Circuit ultimately decided the case on the basis of its own formulation of what was a "trade or business," the investment-plus test.

At issue in *Sun Capital* was the withdrawal liability of two investment funds, Sun Fund III and Sun Fund IV, which received and held investment capital contributed by individual investors and income realized from the investment of such monies. The actual management of such monies was undertaken by a separate investment firm which shared common ownership with the two investment funds. Nonetheless, as to the essentially passive nature of the investment funds, the District Court observed:

> Neither has any employees, owns any office space, or makes or sells any goods. They are simply pools of investment capital managed by a general partner.[54]

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[47] 238 F.3d at 896

[48] 258 F.3d at 643

[49] Id.

[50] 258 F.3d at 644

[51] The Seventh Circuit's discussion in *White* of the defendants' "primary purpose" in leasing apartments above their garage is representative of the courts' concern for an investor's intention in engaging in a particular activity.

[52] *Connors v. Incoal, Inc.*, *supra*. ("[T]he District Court must base its determination of a defendant's purpose on something other than a self-serving statement of intention." 995 F.2d at 254); *Central States, Southeast & Southwest Areas Pension Fund v. Koder*, 969 F.2d 451, 453-454 [15 EBC 2064] (7th Cir. 1992) ("The proper test is not the reasonableness of the taxpayer's belief that a profit will be realized. . ." 969 F.2d at 454.) *UFCW Local One Pension Fund v. 15 McFadden Road, Inc.*, *supra* ("Greater weight is given to objective facts than to a taxpayer's mere statement of intent." 2013 BL 212232; *Chicago Truck Drivers, Helpers & Warehouse Workers Union Pension Fund v. Kelly*, *supra*, ("Of course, a defendant's self-serving statement of intent is not probative of whether an enterprise amounts to a 'trade or business,' rather, the defendant must point to objective evidence that he did not intend to create a business."; *Local 478 Trucking & Allied Indus. Pension Fund v. Jayne*, 778 F. Supp. 1289 [14 EBC 2016] (D.N.J. 1991) ("[C]ourts do not rely upon findings of improper motive or evasion to hold 'trade or business' members of a controlled group liable." 778 F. Supp. at 1306); *Central States, Southeast & Southwest Areas Pension Fund v. Long*, 687 F. Supp. 298 (E.D. Mich. 1987) ("Defendant Long's argument that the carrying on of a trade or business is dependent upon his subjective intent to do so is simply unpersuasive." 687 F. Supp. at 301).

[53] *Central States, Southeast & Southwest Areas Pension Fund v. Messina Trucking, Inc.*, 821 F. Supp.2d 1000 [52 EBC 2173] (N.D.Ill. 2011)(189 PBD, 9/29/11; 38 BPR 1825, 10/4/11), *aff'd in part & rev'd in part*, 706 F.3d 874 (7th Cir. 2013).

[54] 903 F. Supp.2d at 109.

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The claim of withdrawal liability against the investment funds was based on the investment of the funds' capital in, and resulting ownership of a corporate participant in a multiemployer pension plan, Scott Brass, Inc., a manufacturer of brass and copper coil for industrial purposes. When Scott Brass, Inc. filed for bankruptcy and withdrew from the pension plan, the investment funds' ownership in the now-bankrupt corporation implicated the funds as alleged members of the corporation's controlled group.

After Sun Fund III and Sun Fund IV received notice of a withdrawal liability in excess of $4.5 million, the investment funds filed a declaratory judgment action challenging the liability. Despite their admitted common ownership with Scott Brass, Inc. the District Court granted the funds' summary judgment motion.

The District Court reached its decision based on several considerations. First, the Court found that the investment funds' ownership in the now-defunct Scott Brass, Inc. was not sufficient in and of itself to impose withdrawal liability.[55] The fact that Sun Fund III and Sun Fund IV nominally participated in the management of Scott Brass, Inc. by electing directors and by receiving reports and updates on Scott Brass, Inc.'s operations similarly was of no consequence to the District Court "because they performed those acts only as shareholders."[56] Indeed, quoting from the Seventh Circuit's decision in the previously-discussed *Fulkerson* case, the District Court stated:

> It is, however, well settled that merely holding passive investment interests is not sufficiently continuous or regular to constitute a 'trade or business.'[57]

Most significantly, the District Court's decision in *Sun Capital* represented one of the few instances in which a court considering—much less, sustaining—an alleged passive investment addressed the fact that the investment funds had, in fact, made money—a determination on which many other claims of a passive investment had historically foundered under the first prong of the *Groetzinger* test. Despite acknowledging that Sun Fund III and Sun Fund IV had made profits,[58] the court looked to the nature of the profits that the investment funds had realized, rather than the mere fact that profits had been realized. In this regard, the District Court noted that, as reflected on the tax returns of Sun Fund III and Sun Fund IV, the monies that the funds received were either capital gains or dividends which the court characterized as "investment income."[59] Indeed, to the extent that such monies represented investment reimbursement, the District Court found that such monies "are not considered income at all."[60]

Finally, the fact that profits were made by Sun Fund III and Sun Fund IV through a series of interlocking agreements with the funds' financial advisers and Scott Brass, Inc. itself did not, in the District Court's estimation, entangle the investment funds in the web of the employer's withdrawing liability. As the court observed, "That the general partner of each fund was receiving non-investment income does not mean that the Sun Fund itself was engaged in the full range of the general partner's activities."[61]

On appeal, not only did the First Circuit reverse the District Court's summary judgment, but, in so doing, the Court of Appeals repudiated virtually all of the factual bases on which the trial court's decision had been grounded. Contrary to the District Court's characterization of Sun Fund III and Sun Fund IV as mere stockholding companies as part of a mutual fund investment arrangement, the First Circuit found that, by their controlling interests in portfolio companies (such as Scott Brass, Inc.), the investment funds "had become intimately involved in company operations."[62] In this regard, the court determined that individuals affiliated with Sun Fund III and Sun Fund IV "exerted substantial operational and managerial control over [Scott Brass, Inc.] which at the time of acquisition had 208 employees and continued as a trade or business manufacturing metal products."[63] Finally, besides the pure profits that the investment funds received from their ownership of Scott Brass, Inc., the First Circuit also found that such profits were used, in part, to fund management fees paid to the general partners in partnerships in which Sun Fund III and Sun Fund IV participated.[64]

The factual differences which prompted the First Circuit to reject the District Court's decision, however, paled by comparison to the legal standards by which the courts reached their respective conclusions. Whereas the District Court paid lip-service to the *Groetzinger* test to determine the essentially passive investment nature of Sun Fund III and Sun Fund IV,[65] the First Circuit articulated a new standard—the so-called investment-plus test—to control its decision.[66]

The seminal source for the investment-plus test, according to the First Circuit, was a September 2007 appeals letter issued by the PBGC which the District Court had rejected in its decision as "unpersuasive."[67] The letter, which had been issued by an Appeals Board at the PBGC,[68] considered whether a private equity fund had satisfied the first prong of the *Groetzinger* test. The PBGC determined that the private equity fund—like the general partnerships in which Sun Fund III and Sun Fund IV had participated in *Sun Capital*—not only generated profits but also provided management and advisory fees that were paid to the fund's agent. Furthermore, in addressing the regular and continuous element of the *Groetzinger* test, the PBGC, as noted by the First

[55] 903 F. Supp.2d at 117.
[56] *Id.*
[57] *Id.*, *quoting*, *Central States, Southeast and Southwest Areas Pension Fund v. Fulkerson*, *supra*, 238 F.3d at 895-896.
[58] 903 F. Supp.2d at 117-118
[59] 903 F. Supp.2d at 117
[60] *Id.*
[61] 903 F. Supp.2d at 118
[62] 724 F.3d at 134
[63] 724 F.3d at 136
[64] 724 F.3d at 135
[65] 903 F. Supp.2d at 114.
[66] 724 F.3d at 140. As will be discussed, the First Circuit declined to characterize its statement of the investment-plus test as a new or novel incarnation of a legal standard and, instead, relied on pre-existing legal sources including a 2007 PBGC appeals letter as a basis for its decision. Indeed, the First Circuit went to great pains to note that the appellation, investment-plus test, had been coined in an earlier District Court decision that had also relied on the same 2007 PBGC appeals letter. *See*, 724 F.3d at 140; *Board of Trustees v. Palladium Equity Partners, LLC*, *supra*, 722 F. Supp.2d at 869.
[67] 903 F. Supp.2d at 115.
[68] The PBGC Appeals Board has been constituted pursuant to 29 C.F.R. § 4003.59, and renders final agency decisions on various liability and benefit issues.

Circuit, found that "the fund's controlling stake in the portfolio company put it in a position to exercise control through its general partner."[69] Based on the factual similarities between the fact pattern considered by the PBGC Appeals Board and the appeal before it, the First Circuit found that not only was the 2007 appeals letter "[t]he only guidance we have from the PBGC,"[70] but further observed that the 2007 appeals letter was entitled to deference by the court by virtue of the letter's "power to persuade."[71]

Rather than grounding its decision on an administrative ruling that, by its own admission, "was apparently not published, or at least not made widely publicly available through its [the PBGC's] website,"[72] the First Circuit placed particular emphasis on the Seventh Circuit's decision in *Central States, Southeast & Southwest Areas Pension Fund v. Messina Prod., LLC*.[73] In *Messina*, the Seventh Circuit reversed a summary judgment granted to a husband and wife who owned a withdrawing employer-corporation and several affiliated entities and found the couple to be liable as a "trade or business" by virtue of their various commercial activities. While purporting to apply the *Groetzinger* test, the Seventh Circuit stated the elements of its formulation of the investment-plus test[74] as follows:

> In deciding MPPAA cases involving withdrawal liability, we have determined certain factors to be particularly relevant to this analysis, including the defendant's intent in creating the enterprise, how the enterprise is treated for tax purposes, and its legal form.[75]

Turning to the facts before it in the *Sun Capital* appeal, the First Circuit focused on a series of factors that, in its opinion, moved Sun Fund III and Sun Fund IV from the realm of passive investments and into the definition of a "trade or business." These factors included the funds' active involvement in the management and operation of the companies in which they invest,[76] the powers to hire, terminate and compensate certain employees of the portfolio companies,[77] the active search undertaken by the funds and their principals to identify target companies in need of the funds' intervention,[78] the stated purpose of the investment funds to make profits,[79] and the receipt of management fees in addition to profits.[80] In the final analysis, the First Circuit concluded:

> In our view, the sum of all of these factors satisfy the 'plus' in the 'investment plus' test.[81]

[69] 724 F.3d at 140
[70] 724 F.3d at 139
[71] 724 F.3d at 140 and 141, citing to *Skidmore v. Swift & Co.*, 323 U.S. 134, 140 (1944).
[72] 724 F.3d at 139, n.13
[73] See, footnote 53, *supra*.
[74] It should be noted that nowhere in the Seventh Circuit's statement of this legal standard—which was deduced without reference to the earlier-issued 2007 PBGC appeals letter—did the court reference its statement as the investment-plus test.
[75] 706 F.3d at 885
[76] 724 F.3d at 142
[77] *Id.*
[78] *Id.*
[79] *Id.*
[80] 724 F.3d at 143
[81] *Id.*

Conclusion

Not surprisingly, the reversal by the First Circuit evoked a petition for certiorari from the disappointed plaintiffs. What may have been surprising, however, was the unanimity with which the Supreme Court denied the petition on March 3, 2014.[82] While legal commentators may speculate as to the reasons for the Court's rejection of this appeal, it certainly was not uniformity in the legal standards applied or results reached by the Circuit Courts and the District Courts that have attempted to divine the meaning of what constitutes a "trade or business." Indeed, the diversity, and often contradictions, in outcomes and analytic approaches would have seemingly commanded intervention by the highest court in the land.

A review of the decisions rendered by courts that have weighed in on this issue discloses few items as to which there is no dispute. Even the statutory requirement that regulations adopted to implement the purposes of ERISA be "consistent and co-extensive" with the regulations adopted under the Tax Code has not been above judicial criticism.[83]

Yet nowhere has guidance from the Supreme Court been more needed than on the manner in which a "trade or business" is to be defined under Section 1301(b)(1) [29 U.S.C.§ 1301(b)(1)] for the purpose of imposing withdrawal liability. While the *Groetzinger* test has seemingly won majority acceptance, as previously noted, the *Groetzinger* test has not found universal acceptance.

Furthermore, given courts' ongoing resort to the two progeny of the *Groetzinger* test—the passive investment and investment-plus tests, both of which profess continued adherence to *Groetzinger*—the failure and inability to achieve consistent interpretations of what is a "trade or business" contributes to the plethora of legal actions that continue to be filed in the absence of direction from the Supreme Court. Indeed, even the original fact-based ad hoc test has retained a limited vitality with certain courts which have tried to identify certain circumstances which automatically qualify a business as a "trade or business." For example, the Seventh Circuit has held a lease arrangement between a member of a controlled group and a withdrawing employer to be a per se "trade or business."[84]

This is not to say, however, that *Sun Capital's* importance is somehow diminished as a result of the Supreme Court's refusal to hear the appeal. The decision has already had a ripple effect within the private investment industry. While it may not have been a "reach" for a Court to hold the investment funds in *Sun Capital* to be "trades or business" for tax purposes (a la *Groetzinger*), it was an entirely different matter to extend that definition to an ERISA/MPPAA context within which withdrawal liability consequences may be substantial. As a result of *Sun Capital*, both financial advisors and their attorneys are revisiting the structures and opera-

[82] ___ U.S. ___, 2014 BL 57911 (2014)
[83] *Central States, Southeast & Southwest Areas Pension Fund v. Ditello*, 974 F.2d 887, 889 (7th Cir. 1992)
[84] *Id. See also, Central States, Southeast & Southwest Areas Pension Fund v. Nagy*, 714 F.3d 545, 550 [56 EBC 2542] (7th Cir. 2013)(78 PBD, 4/23/13; 40 BPR 1063, 4/30/13); *Board of Trustees v. Del Valley Sign Corp., supra*, 945 F. Supp. 2d at 654-655.

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tions of investment funds since withdrawal liability has been held to encompass the funds themselves, and not just the managers of the funds. For example, resort to the so-called Insignificant Participation[85] and the Venture Capital Operating Company Exceptions[86] recognized by ERISA are means of potentially avoiding withdrawal liability for investment funds.[87]

The significance of the *Sun Capital* case for withdrawal liability analyses may be blurred by the manner in which the First Circuit addressed the issue of what constitutes a "trade or business." Rather than resolving this issue, the First Circuit added to the cacophony of divergent legal standards, holdings and results that already mark this troubled area of the law. By its unwillingness to weigh in on what constitutes a "trade or business" for the purposes of imposing withdrawal liability, the Supreme Court may have avoided a thorny issue but, by its failure to do so, contributed to the existing dissonance.

The *Sun Capital* case not only provided the Supreme Court with an opportunity to comment on the latest permutation of what represents a "trade or business," but the chance to leave its imprint on the emerging wave of withdrawal liability cases arising under ERISA and MPPAA. As already noted, because of the mechanical manner in which the "common ownership" component of withdrawal liability is determined, the number of cases requiring construction of this component pales by comparison to the increasing number of "trade or business" cases. As a result, a decision by the Supreme Court on the definition of a "trade or business" could have had significant implication for multiemployer pension plans and the innumerable attorneys who advocate and defend the interests of the even-more innumerable participants of such plans.

At my induction ceremony to the federal and state bars of New Jersey, the keynote speaker, the then-presiding judge of the District court, compared appellate judges to Olympian gods who watch the battle swirling below them. . .and then swoop down to kill all the survivors! In *Sun Capital*, the "gods" simply decided to let the survivors live to fight another day.

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[85] 29 C.F.R. § 2510.3-101(f)(1)

[86] 29 C.F.R. § 2510.3-101(a), (c) & (d)

[87] Joseph K. Urwitz, "View from McDermott: What Private Equity and Hedge Funds (and the Benefit Plan Investors) Should Know About ERISA" (88 PBD, 5/7/14; 41 BPR 1043, 5/13/14).