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PERSPECTIVES

WHEN ARE PRIVATE EQUITY FIRMS LIABLE FOR ACTS OF THEIR PORTFOLIO COMPANIES?

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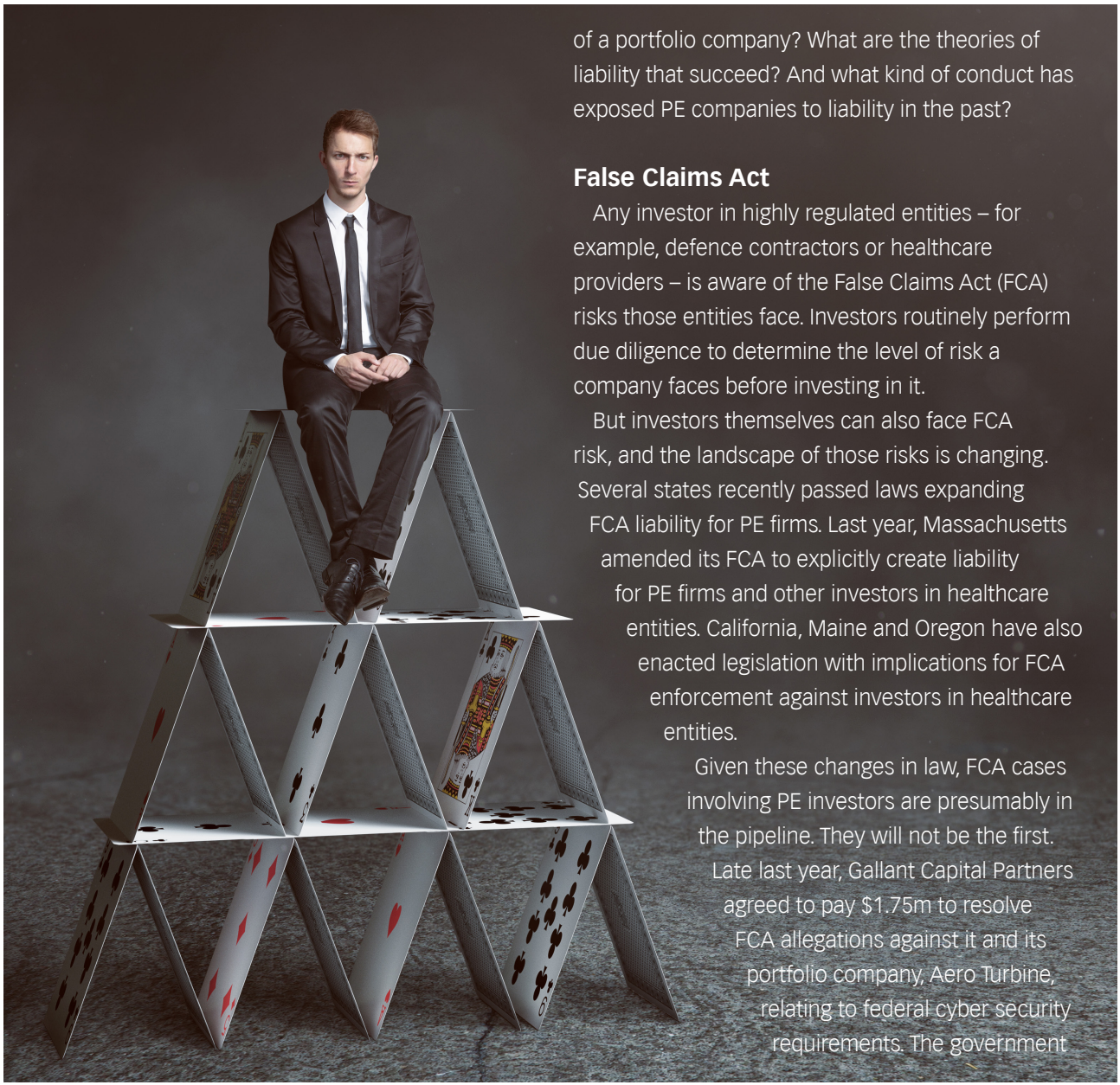
Corporate separateness is a linchpin of modern investment, allowing capital to flow without exposing private equity (PE) investors for every decision made by a portfolio company. But a string of recent decisions and settlements involving claims of fraud, anticompetitive conduct and regulatory violations provide clear reminders that the protections offered by the corporate form are not iron clad.

The latest example landed just two months ago, when a federal court allowed claims against Bain Capital to proceed based on a data breach at one of its most recent acquisitions – an educational software provider called PowerSchool servicing 60 million students and 10 million teachers.

Notably, the court refused to dismiss certain claims against Bain based in part on PowerSchool's acts before Bain's acquisition was complete. The complaint alleged that Bain conditioned its investment on certain cost reduction measures, like offshoring cyber security functions, which PowerSchool undertook and which contributed to the data breach.

The PowerSchool case raises questions any investor would want to ask before taking a stake in an operating company. What are the common claims brought against PE companies based on acts



of a portfolio company? What are the theories of liability that succeed? And what kind of conduct has exposed PE companies to liability in the past?

False Claims Act

Any investor in highly regulated entities – for example, defence contractors or healthcare providers – is aware of the False Claims Act (FCA) risks those entities face. Investors routinely perform due diligence to determine the level of risk a company faces before investing in it.

But investors themselves can also face FCA risk, and the landscape of those risks is changing. Several states recently passed laws expanding FCA liability for PE firms. Last year, Massachusetts amended its FCA to explicitly create liability for PE firms and other investors in healthcare entities. California, Maine and Oregon have also enacted legislation with implications for FCA enforcement against investors in healthcare entities.

Given these changes in law, FCA cases involving PE investors are presumably in the pipeline. They will not be the first. Late last year, Gallant Capital Partners agreed to pay $1.75m to resolve FCA allegations against it and its portfolio company, Aero Turbine, relating to federal cyber security requirements. The government

alleged that "a Gallant employee assisting" Aero Turbine was involved in the violations.

Importantly, the settlement followed Gallant's voluntary self-disclosure and extensive cooperation with the government, which is detailed in the settlement agreement. Both Gallant and Aero Turbine received credit for that cooperation, but it was not enough to avoid a monetary settlement.

While Gallant's liability appears to have flowed from an employee's involvement in the provision of classified information, liability under Massachusetts' amended FCA flows from knowledge of and failure to report a violation.

Anticompetitive conduct

PE firms can face antitrust risks, too, sometimes in surprising ways. Last year, the Department of Justice sued KKR for alleged violations of the Hart-Scott-Rodino Act. And antitrust liability can flow from interlocking directorates, when an investor places board members across competing companies simultaneously.

But PE firms can also face liability from actions of their portfolio companies. One path to liability is involvement by the investor in the prohibited conduct.

In 2024, Lion Capital settled antitrust claims relating to a tuna price-fixing conspiracy involving its portfolio company, Bumble Bee Tuna. Lion Capital claimed it engaged in normal investment activities, like appointing board members. But the court found enough evidence to go to trial, including an internal whistleblower letter, materials unearthed during Lion Capital's due diligence, and a meeting with a competitor.

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And in an oft-cited settlement from 2019, American Securities paid $13m to settle antitrust claims relating to its portfolio company's price-fixing scheme for water treatment chemicals. American Securities was unable to dismiss the case because the plaintiffs specifically alleged, among other things, that it required approval of bids over a certain

amount, received reports on pricing and gave instructions on bidding conduct.

Another path to antitrust liability for PE firms is through roll-ups. Last year, Welsh Carson, Anderson & Stowe settled antitrust claims brought by the Federal Trade Commission (FTC) relating to a roll-up of anaesthesia providers in Texas. The FTC alleged Welsh Carson's strategy created a single, dominant provider with the power to demand higher prices. The settlement prohibits Welsh Carson from increasing its investment of ownership of the portfolio company and requires that it reduce its board representation to one non-chair seat and obtain FTC approval for any investment in an anaesthesia business.

Roll-up antitrust liability is not without precedent. In 2022, JAB Consumer Partners faced multiple antitrust enforcement actions arising from roll-ups of veterinary clinics. Both of JAB's settlement agreements with the FTC required divestment of some veterinary clinics, as well as prior approval and prior notice requirements for further acquisitions.

Labour and employment

Late last year, a court found that a pooled PE fund operated by Longroad Asset Management could be liable under ERISA, the Employee Retirement Income Security Act of 1974, after one of its portfolio companies ceased operations and stopped contributing to a pension fund.

The PE fund owned a 95 percent interest in the portfolio companies and, crucially, actively managed the portfolio companies by embedding advisers and appointing board members. Importantly, however, the court held that the PE fund's general partner and management company were not subject to liability.

And Black Diamond Capital was unable to defeat liability at summary judgment in a WARN Act suit arising from closure of a steel plant owned by one of its portfolio companies, Bayou Steel. The WARN Act requires 60 days advance notice for any plant closing or mass layoff.

The question at summary judgment was whether Black Diamond was an "employer" under the WARN Act, and that question turned on Black Diamond's de facto control of Bayou Steel. Evidence that Black Diamond was "intimately involved" in and even "micromanaged" Bayou Steel's operations was sufficient to create an issue of fact on its de facto control over the decision to close the plant.

However, Black Diamond ultimately prevailed at trial. In May, the Fifth Circuit affirmed the verdict because the plaintiffs could not ultimately prove who directed closure of the plant.

Privacy and data security

In March 2026, a federal court denied Bain Capital's motion to dismiss a complaint against it and its recent acquisition, PowerSchool, following a data breach. The complaint alleged Bain and PowerSchool

had been discussing a merger for two years, and that Bain emphasised cost-cutting measures in those discussions. After negotiations had begun but before Bain agreed to the acquisition, PowerSchool announced plans to offshore its cyber security and IT functions.

Bain agreed to acquire a 51 percent stake in PowerSchool in June 2024. In August, before the merger closed, hackers breached PowerSchool's systems, and data exfiltration occurred in September. The merger closed in October, and Bain began offshoring cyber security and IT functions to a vendor called Movate. In December, hackers used employee credentials stolen from Movate to access PowerSchool's student information.

The court held Bain could be liable for the data breach based both on its pre-merger and post-merger conduct. The complaint alleged Bain "conditioned its offer on cost reduction measures consistent with its acquisition strategy" of offshoring IT functions to cheaper, less secure vendors. The court held these conditions contributed to the harm, which supported theories of liability based on agency, direct liability, aiding and abetting, and negligence.

Lessons and common threads

Active involvement versus passive investment. The most common thread running through these cases is the distinction between active involvement and passive investment. The closer the active involvement is to liability-triggering conduct, the more the investor is exposed.

For example, in the Bumble Bee Tuna price-fixing case, liability turned on extensive allegations of Lion Capital's knowledge of and involvement in the price-fixing scheme, including through in-person meetings with competitors with whom Bumble Bee allegedly coordinated prices. But the court noted liability should not arise from typical investment activities, like "monitoring of the subsidiary's performance, supervision of the subsidiary's finance and capital budget decisions, and articulation of general policies and procedures".

Active involvement is not always necessary. However, active involvement is not always a prerequisite to liability. Take the recent amendments to Massachusetts' False Claims Act statute. While typical FCA violations require a showing that a party caused a submission of a false claim, Massachusetts' amendments create liability for PE firms and managed funds with direct or indirect interest in a company if they know of an FCA violation and fail to report it "within 60 days of identifying the violation".

And exposure to antitrust enforcement actions relating to roll-ups can arise without active involvement in operations, too. The Welsh Carson and JAB Consumer Partners settlements related to the roll-up activity itself, not day-to-day decision

making. And while the remedies in those settlements did not involve monetary relief, they still involved burdensome restrictions that could affect the value of past and future investments.

Pre-acquisition conduct. The PowerSchool case is sure to trigger many questions about investors' liability for conduct of portfolio companies prior to acquisition. But prior conduct has been relevant to investor liability in the past.

For example, in the Bumble Bee Tuna case, the complaint alleged Lion Capital had all the evidence it needed to conclude price-fixing was occurring based on its pre-investment due diligence and its sophistication. And weeks before the acquisition was completed, Lion Capital met with executives from two competing tuna groups, and one of the "key messages" Lion Capital allegedly sought to communicate was that Bumble Bee would "support rational market behavior". The court held it was reasonable to infer that "rational market behavior" meant collusion.

However, the holding in the PowerSchool decision goes further. The district court held that Bain's pre-merger manifestations – like conditioning the merger on cost-reduction measures – allowed PowerSchool to act on Bain's behalf and exposed Bain to liability. The decision raises the prospect of liability for PE firms based on incentives and milestones for potential investments, which would extend exposure to pre-acquisition conduct by portfolio companies. It could even extend liability for PE investors to acts by companies which never received an investment.

PowerSchool should serve as an example to investors, cautioning them to consider how their pre-merger incentives may set the stage for allegations of control that might expose them to liability. But whether Bain's pre-merger conduct is ultimately sufficient to create liability is not yet clear, and Bain will have other opportunities, including a pending motion for reconsideration, to prove otherwise. CD

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