Case No. 01-3255

UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

Benefits Committee of Saint-Gobain Corporation, et al.,
Plaintiffs-Appellants

v.

Key Trust Company of Ohio, N.A.,
Defendant-Appellee

Appeal from the United States District Court
for the Northern District of Ohio

BRIEF OF THE SECRETARY OF LABOR AS *AMICUS CURIAE* IN SUPPORT OF DEFENDANT-APPELLEE KEY TRUST CO.

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Federal Cases: Page

Federal cases–continued: Page

Federal Statutes: Page

Other Authorities: Page

INTEREST OF THE SECRETARY OF LABOR

The Secretary of Labor ("the Secretary") has primary authority to interpret and enforce Title I of the Employee Retirement Income Security Act ("ERISA" or the "Act"), as amended, 29 U.S.C. §§ 1001 et seq., and therefore has a strong interest in ensuring that the ERISA fiduciary standards are correctly applied in the administration of assets of employee benefits plans. The Secretary's interests further include promoting the uniform application of the Act, protecting plan participants and beneficiaries, and ensuring the financial stability of plan assets. Secretary of Labor v. Fitzsimmons, 805 F.2d 682, 688-94 (7th Cir. 1986) (en banc). The Secretary has a heightened interest in transactions involving leveraged (debt-financed) employee stock ownership plans ("ESOPs"), as in the subject case, because Congress, in enacting ERISA, expressed particular concern about these transactions and directed the Secretary to give them "special scrutiny." H.R. Rep. No. 93-1280, 93rd Cong., 2d Sess. at 313 (1974), reprinted in 1974 U.S.C.C.A.N. 5038, 5093.

STATEMENT OF THE CASE

Acting as a fiduciary of the Furon Company Employee Stock Ownership Plan ("Plan" or "ESOP"), the Benefits Committee of Saint-Gobain Corporation ("Benefits Committee"), filed this action against Key Trust of Ohio, N.A. ("Key Trust" or "Trustee"), the ESOP's trustee. The ESOP is an employee

benefit plan subject to ERISA, and the Benefits Committee brought the action under 29 U.S.C. § 1132(a)(3) to compel Key Trust to transfer specific ESOP assets to Saint-Gobain Performance Plastics Corporation ("Saint-Gobain Plastics"). Key Trust counterclaimed for a declaratory judgment that its fiduciary duties under ERISA preclude remittance of the demanded payment.

On cross-motions for summary judgment, the district court denied all of the Benefits Committee's claims and granted summary judgment to Key Trust on its counterclaim. The Benefits Committee timely appeals from this judgment.

STATEMENT OF FACTS

The Secretary as amicus curiae adopts the district court's findings of fact, which are summarized below.

The ESOP and the Parties

In 1990, the Furon Company ("Furon") established the ESOP as an employee benefit plan for its employees, designed to invest primarily in stock issued by Furon. R. 25 at 2-3. The Benefits Committee administers the ESOP, and Key Trust holds the ESOP's assets in trust. R. 25 at 2-3. Saint-Gobain Corporation ("Saint-Gobain"), which is a successor to Furon, appoints the Benefits Committee's members and also may remove them at will, with or without

cause. R. 25 at 2 and 4-6; R. 19, Exh. A at § 13.4.[1] The Benefits Committee and Key Trust both are fiduciaries of the ESOP, within the meaning of ERISA § 3(21)(A), 29 U.S.C. § 1002(21)(A). R. 25 at 2.

Eligible Furon employees who participate in the ESOP own individual accounts in the ESOP, and the ESOP allocates to these accounts credits based on the Furon stock purchased by the ESOP. R. 25 at 2-4. The benefits payable by the ESOP are the balances in participants' accounts. R. 25 at 4 and 6.

The ESOP's Purchases of Furon Stock

The ESOP purchased blocks of Furon stock periodically during 1990-97. R. 25 at 3-4. Furon financed each purchase by lending to the ESOP each block's entire purchase price. R. 25 at 3-4. These stock purchase loans are called "Exempt Loans" because they satisfy exemptions from otherwise applicable prohibitions in the Internal Revenue Code ("Code") and ERISA. R. 25 at 3-4.

The Trustee did not allocate (or credit) this stock to participants' ESOP accounts immediately upon purchase but, instead, as provided in the ESOP's governing documents, held it in the ESOP's Suspense Subfund. R. 25 at 4. Furon stock in the Suspense Subfund is "Unallocated Stock," and the ESOP's proceeds from its sale are "Unallocated Proceeds." As the ESOP made loan

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[1] "R. 19 Exh." denotes an exhibit to the parties' Stipulations of Fact, which are record entry 19.

repayments, it released Unallocated Stock from the Suspense Subfund to participants' ESOP accounts in proportion to the repayment amounts. R. 25 at 4.

The Loan Agreements

Furon did not take a security interest in the ESOP's Unallocated Proceeds, and the Exempt Loans are unsecured. R. 25 at 4. For each Exempt Loan, Furon and the ESOP executed a written loan agreement (the "Loan Agreements"). Under the Loan Agreements, Furon promised to remit to the ESOP contributions sufficient to enable the ESOP to make timely loan payments; agreed that a scheduled loan payment not made solely because of Furon's failure to make such required contributions is not a default by the ESOP; and further agreed that, if it failed to make such required contributions, the ESOP Trustee's obligation to pay principal and interest due on the loans is suspended until Furon makes the necessary contribution. R. 25 at 13.

In construing the Loan Agreements, the district court found that Key Trust's obligation to repay the Exempt Loans is entirely dependent on Furon/Saint-Gobain Plastics making the anticipated contributions to the ESOP. R. 25 at 14. Absent those contributions, the district court found further, the Loan Agreements impose on Key Trust no duty to repay the Exempt Loans further. R. 25 at 14.

Acquisition of Furon and Amendment of the ESOP Plan Document

In 1999, Saint-Gobain purchased all of Furon's outstanding stock for cash, including the Unallocated Stock in the ESOP's Suspense Subfund and renamed Furon as Saint-Gobain Plastics. R. 25 at 5-6. On March 17, 2000, Section 15.4 of the ESOP's plan document was amended to provide in part that " [u]pon termination of the Plan . . . any unallocated proceeds . . . held in the Suspense Subfund shall, . . . to the extent permitted by the [Internal Revenue] Code and Regulations, be returned to the Company in full satisfaction of such Exempt Loan." R. 25 at 14-15. The district court found that this amendment did not grant Saint-Gobain Plastics a security interest in the ESOP's Unallocated Proceeds. R. 25 at 22.

Termination of the ESOP

After it amended section 15.4 of the plan document, Saint-Gobain Plastics terminated the ESOP and permanently ceased making contributions to it. R. 25 at 6-7, 11-13, and 14. As a consequence, the district court found, "[Key Trust's] obligation under the Loan Agreements to make payments on the Exempt Loans has been suspended" and suspended "permanent[ly]." R. 25 at 11 and 14. In a further finding, "because [Key Trust's] failure to repay [further] is solely a result of Saint-Gobain Plastics' failure to make further contributions," it "does not constitute a default. . . ." R. 25 at 13.

Relying on plan document section 15.4, as amended, the Benefits Committee then demanded that Key Trust pay approximately $2,300,000 of the ESOP's remaining Unallocated Proceeds to Saint-Gobain Plastics. Key Trust refused on the ground that its fiduciary duties preclude such payment. R. 25 at 6- 7. The subject action ensued.

ARGUMENT

I. The district court correctly held that Key Trust's remittance of the demanded payment would breach its fiduciary duties under ERISA.

ERISA's seminal purposes are to safeguard the interests of participants and to preserve the integrity of plan assets, and it is to these ends that courts must interpret and apply the Act's provisions. Gilliam v. Edwards, 492 F. Supp. 1255, 1261 (D.N.J. 1980). ERISA § 404(a)(1)(A) requires a fiduciary to "discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and for the exclusive purpose of providing benefits to participants and beneficiaries." 29 U.S.C. § 1104(a)(1)(A). Fiduciary loyalty is "an unwavering duty on an ERISA trustee to make decisions with single-minded devotion to a plan's participants . . . ." Adams v. Avondale Indus., Inc., 905 F.2d 943, 946 (6th Cir.), cert. denied, 498 U.S. 984 (1990). Thus, every action of both the Benefits Committee and Key Trust, as the ESOP's fiduciaries, must comport with those ends and "must be made with an eye single to the interests of the participants and beneficiaries." Donovan v. Bierwirth, 680 F.2d 263, 271 (2d Cir. 1982), cert. denied, 459 U.S. 1069 (1982) (describing "the complete loyalty to participants demanded of . . . trustees of a pension plan" under ERISA).

By remitting to the ESOP's sponsoring employer a payment which the ESOP has no obligation to make, Key Trust clearly would violate this duty of

fiduciary loyalty. In this appeal, it is stipulated that, under the Loan Agreements, the ESOP's loan repayment obligation was suspended if Furon failed to make its promised contributions to the ESOP. It is further stipulated that Saint-Gobain Plastics permanently ceased all contributions to the ESOP after acquiring Furon. Indeed, as it must, the Benefits Committee concedes that, "[i]n short, [Saint-Gobain Plastics] has no enforceable right to repayment under the Loan Agreements." BC Br. at 23.

Any remittance of ESOP assets to Saint-Gobain Plastics in the guise of a "loan repayment" thus would be gratuitous. It is axiomatic that the transfer of plan assets where there is no obligation to do so or without equivalent consideration violates ERISA. Marshall v. Cuevas, 1 BNA Employee Benefits Cases ("EBC") 1580-81 (D.P.R. 1979) ((plan fiduciaries violated the loyalty provisions of ERISA § 404(a)(1)(A) by transferring plan assets to the destitute widow of a deceased trustee when they had no obligation to do so)); Reich v. Compton, 57 F.3d 270, 272-73, 290-91 (3rd Cir. 1995) (breach of fiduciary loyalty to transfer a plan asset for well under its accounting value).

Fiduciary loyalty also requires Key Trust to assert and defend the ESOP's rights under the Loan Agreements. In Dairy Fresh Corp. v. Poole, 108 F. Supp. 2d 1344 (S.D. Ala. 2000), where the sponsoring employer sued the ESOP to obtain one-half of its assets, the ESOP's trustee breached his duty of loyalty by

initially acquiescing in the claim against the ESOP, by raising no defenses to the claim, and by failing to investigate its basis. Id. at 1352-53, 1359-61.

Accordingly, in assessing Key Trust's compliance with its fiduciary duty of loyalty should it comply with the Benefits Committee's demand for the payment, the district court correctly observed:

> If [Key Trust] were to repay the Exempt Loans when it has no legal obligation to do so, it would not be acting solely in the interest of the participants of the Furon ESOP. For clearly it is in the participants' interest to maximize the amount of their benefits and not have their benefits reduced by payment of unsecured, unenforceable debts.

R. 25 at 22-23.

Remittance of the unobligated payment additionally would breach Key Trust's duty of prudence, codified in ERISA § 404(a)(1)(B), "to discharge [its] duties . . . with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in like capacity and familiar with such matters would use . . . ." 29 U.S.C. § 1104(a)(1)(B). Because, as the district court found, the demanded payment would cause an unecessary and permanent loss to the ESOP participants (R. 25 at 9-10 and 22-23), its remittance would be patently imprudent. See Compton, 57 F.3d at 272-73, 290-91; Hunter v. Caliber Sys., Inc., 220 F.3d 702, 723 (6th Cir. 2000) (a transaction is imprudent if it is not structured appropriately for the plan's interests).

By refusing to comply with the Benefits Committee's demand, Key Trust further comported with its fiduciary responsibility that, with exceptions not relevant here, "the assets of [an ESOP] plan shall never inure to the benefit of any employer . . . ." ERISA § 403(c)(1), 29 U.S.C. § 1103(c)(1). As the district court correctly noted: "[P]ayment of the Exempt Loans by [Key Trust] in this situation would benefit only Saint-Gobain Plastics -- precisely the party who is never intended to benefit from an ESOP." R. 25 at 23.

Moreover, solely because the ESOP's Unallocated Proceeds are not collateral for the Exempt Loans, Key Trust's use of them as a source for the demanded payment would in itself violate the Act. In advisory opinions on analogous facts, the Department of Labor has concluded that an ESOP fiduciary will breach its duties of loyalty and prudence under ERISA § 404(a)(1), among others, if it pays off ESOP-owed debt by using unallocated stock in which the lender does not have a security interest. DOL Advisory Opinion ("AO") 93-35A, 1993 WL 562217, at **2-3 (Dec. 23, 1993); DOL Information Letter ("IL") AO 0420, 1997 WL 1824020, at *3 (Dec. 17, 1997).

In sum, by remitting the demanded payment, Key Trust would breach multiple fiduciary duties. The district court correctly so held.

II. Remittance by the Trustee would constitute a transaction prohibited by ERISA § 406(a)(1)(D), 29 U.S.C. § 1106(a)(1)(D).

Except for the exempt transactions delineated in ERISA § 408, 29 U.S.C. § 1108, ERISA § 406(a)(1)(D) prohibits a plan fiduciary from knowingly causing a direct or indirect "transfer to, or use by or for the benefit of, a party in interest of any assets of the plan." 29 U.S.C. § 1106(a)(1)(D). By employing the ESOP's participants, Saint-Gobain Plastics is a statutory party in interest with respect to the Furon ESOP. ERISA § 3(14)(C), 29 U.S.C. § 1002(14)(C). Thus, unless exempted, Key Trust is prohibited from transferring any ESOP assets to or for the benefit of Saint-Gobain Plastics.

The demanded payment here cannot meet any exemption from, and therefore would violate, the prohibition of ERISA § 406(a)(1)(D). A loan to an ESOP and its repayment are exempt from the prohibitions of ERISA § 406(a) pursuant to ERISA § 408(b)(3) if, inter alia, the loan (including its repayment) "is primarily for the benefit of participants and beneficiaries of the plan." 29 U.S.C. § 1108(b)(3). Here, as the district court found, the remittance of an unobligated "payment" on the Exempt Loans would result in an uncompensated and permanent loss to the ESOP's participants. Thus, the § 408(b)(3) exemption cannot apply and, consequently, § 406(a)(1)(D) prohibits the demanded payment of ESOP assets to Saint-Gobain Plastics. E.g., Marshall v. Mercer, 4 EBC 1523, 1535 (N.D.

Tex. 1983), aff'd in part and rev'd in part on other grounds, 747 F.2d 304 (5th Cir. 1984); Donovan v. Williams, 4 EBC 1237, 1241-42, 1245 (N.D. Ohio, 1983); Marshall v. Kelly, 465 F. Supp. 341, 347, 351 (W.D. Okla. 1978).

In an attempt to evade the prohibition mandated by § 406(a)(1)(D), the Benefits Committee argues that the § 408(b)(3) exemption and the regulation issued thereunder, 29 C.F.R. § 2550.408b-3, must be interpreted to permit use of an ESOP's unallocated proceeds to repay an unsecured, exempt loan. BC Br. at 37-39. Otherwise, it contends, an ESOP cannot legally repay any exempt loan that is unsecured or, alternatively, that only loans secured by the ESOP's unallocated stock will satisfy the § 408(b)(3) exemption. BC Br. at 37-39.

The argument is inapposite to the facts in this record. First, the Benefits Committee nowhere attempts to suggest that, where, as the district court found here (R. 25 at 11 and 13-14), the lender's own actions have permanently suspended the ESOP's loan payment obligation, any further loan payments can be "primarily for the benefit of the participants and beneficiaries of the plan." 29 U.S.C. § 1108(b)(3), 29 C.F.R. § 2550.408b-3(b)(2). Second, the Benefits Committee overlooks a known method through which an ESOP can repay an unsecured, exempt loan consistently with ERISA. As the district court explained (R. 25 at 18 n.6), if, as here, the ESOP's loan payment obligation is limited to the employer's contributions to the ESOP, then the lender will receive all scheduled

loan payments if the employer maintains the ESOP long enough to make the contributions necessary for the ESOP to make those scheduled payments. In such a structure, the lender could enforce a claim against the ESOP for payment from the ESOP's contribution receipts. Here, however, Furon chose to not secure the Exempt Loans and Saint-Gobain Plastics, Furon's successor, chose to terminate the ESOP before the loans matured. Ibid.

The Benefits Committee further posits that the fiduciary duties owed to the ESOP under ERISA § 404(a)(1) should not apply to exempt loans. But in doing so, it overlooks well-settled law to the contrary. An ERISA § 408 exemption does no more than avoid the prohibitions of § 406 of the Act; it does not exempt the transaction from the fiduciary duties mandated in ERISA § 404(a)(1). This Court and other circuits have repeatedly approved this construction of ERISA, which Congress explicitly set forth in ERISA's legislative history. Kuper v. Iovenko, 66 F.3d 1447, 1458 (6th Cir. 1995); Martin v. Feilen, 965 F.2d 660, 665 (8th Cir. 1992), cert. denied, 506 U.S. 1054 (1993); McMahon v. McDowell, 794 F.2d 100, 110 (3rd Cir.), cert. denied, 479 U.S. 971 (1986); Donovan v. Cunningham, 716 F.2d 1455, 1467 (5th Cir. 1992), cert. denied, 467 U.S. 1251 (1984); Eaves v. Penn, 587 F.2d 453, 459 (10th Cir. 1978); S. Rep. No. 93-127 at 31, reprinted in 1974 U.S.C.C.A.N. 4838, 4867.

III. The district court correctly rejected the Benefits Committee's argument that the plan document authorizes Key Trust to make the demanded payment.

Conceding that Saint-Gobain Plastics has no enforceable right to repayment under the Loan Agreements, the Benefits Committee argues that it is nevertheless entitled to receipt of the loan balance pursuant to Section 15.4 of the ESOP's plan document.[2] The argument ignores well established law.

ERISA § 404(a)(1)(D) requires plan fiduciaries to act "in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of this title and title IV." 29 U.S.C. § 1104(a)(1)(D) (emphasis added). Because the demanded payment would be a fiduciary breach under § 404(a) (1) and a nonexempt transaction prohibited by § 406(a)(1)(D), the ESOP's governing documents cannot authorize the payment even though they purport to do so. "Trust [or plan] documents cannot excuse trustees from their duties under ERISA." Central States, Southeast & Southwest Areas Pension Fund v. Central Transport, Inc., 472 U.S. 559, 568 (1985); Utilicorp United, Inc. v. Kemper Financial Services, Inc., 741 F. Supp. 1363, 1365-66 (W. D. Mo. 1989) (compliance with plan documents cannot be a defense to a charge of fiduciary breach). If acting in accordance with the plan document would

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2 The district court found that section 15.4, as amended, did not grant Saint-Gobain Plastics a security interest in the Unallocated Proceeds. R. 25 at 22.

result in a violation of the Act , a fiduciary must refrain from so acting. Herman v. Nationsbank Trust Co., 126 F.3d 1354, 1368-69 (11th Cir. 1997), cert. denied, 525 U.S. 816 (1998); Central Trust Co. v. American Avents Corp., 771 F. Supp. 871, 875-76 (S.D. Ohio 1989); First Nat'l Bank of Chicago v. Retirement Trust, No. 90 C 3981, 1991 WL 285269, at *2 (N.D. Ill. Dec. 27, 1991). Had Key Trust repaid the loan balance from the Unallocated Proceeds in reliance on the "authority" expressed in the ESOP plan document, it could not have escaped the consequences of its resulting fiduciary breach.

The Benefits Committee's argument additionally ignores countervailing provisions in the ESOP's trust agreement that specifically relieve Key Trust from following the provisions of section 15.4. By their terms, the ESOP's plan document and trust agreement must be construed as a single, integrated document. R. 25 at 15. Section 3.2(d) of the trust agreement provides:

> Notwithstanding any other provision of the Trust Agreement, the Trustee shall not be required to comply with any provision of the Trust Agreement that is not consistent with the requirements of Title I of ERISA.

The Benefits Committee's argument to the contrary notwithstanding, then, the ESOP's governing documents in terms do not require Key Trust, as the ESOP trustee, to comply with plan document section 15.4 where, as here, compliance would cause a fiduciary breach.

Finally, in arguing that section 15.4 of the plan document requires Key Trust to make the demanded payment, the Benefits Committee relies on two private letter rulings ("PLRs") issued by the Internal Revenue Service ("IRS"). IRS Priv. Ltr. Rul. 9416043, 1994 WL 141568, at *3 (Jan. 28, 1994); IRS Priv. Ltr. Rul. 8044074, 1980 WL 135505, at *3 (Aug. 11, 1980). This excise tax exemption and its subsidiary Treasury regulation incorporate the same criteria as the ERISA § 409(b)(3) exemption and its exempt loan regulation cited above.[3]

These PLRs have no application, however, to fiduciary breach issues concerning the demanded payment in issue here. First, as the IRS expressly noted in both PLRs, its jurisdiction there extended only to excise tax questions so that it could express no opinion on any fiduciary standards imposed by Title I of ERISA. 1980 WL 135505 at *4; 1994 WL 141568 at *4.

Second, these two PLRs differ from this case factually. They concern ESOPs with enforceable loan payment obligations, unlike the Furon ESOP which, solely because of Saint-Gobain Plastics' own failure to make promised contributions to the ESOP, has no further loan payment obligation. Additionally, unlike the Furon ESOP's unsecured Exempt Loans, PLR 8044074 does not indicate whether the ESOP's unallocated stock secured the exempt loan.

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3 Compare 26 U.S.C. § 4975(d)(3) to 29 U.S.C. § 1106(a)(1)(D), and compare 26 C.F.R. § 54.4975-7(b)(5) to 29 C.F.R. § 2550.408b-3.

CONCLUSION

For the foregoing reasons, the judgment below should be affirmed.

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Dated: 22 June 2001

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CERTIFICATE OF COMPLIANCE WITH RULE 37(a)(7)(C)

This brief is printed in proportionally spaced, 14-point, Times New Roman type, contains 3538 words as measured by Word Perfect 8, and complies with the type-volume limitations imposed by Fed. R. App. P. 37(a)(7(c) and 29(d).

Peter B. Dolan

CERTIFICATE OF SERVICE

I hereby certify that on June 22, 2001, copies of the foregoing

BRIEF OF THE SECRETARY OF LABOR AS AMICUS CURIAE
IN SUPPORT OF DEFENDANT-APPELLEE
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APPENDIX

Donovan v. Williams, 4 BNA Employee Benefits Cases ("EBC") 1237 (N.D. Ohio, 1983)

First Nat'l Bank of Chicago v. Retirement Trust, No. 90 C 3981, 1991 WL 285269 (N.D. Ill. Dec. 27, 1991)

Marshall v. Cuevas, 1 EBC 1580-81 (D.P.R. 1979)

Marshall v. Mercer, 4 EBC 1523, 1535 (N.D. Tex. 1983), aff'd in part and rev'd in part on other grounds, 747 F.2d 304 (5th Cir. 1984)

DOL Advisory Opinion 93-35A, 1993 WL 562217 (Dec. 23, 1993)

DOL Information Letter AO 0420, 1997 WL 1824020 (Dec. 17, 1997)

IRS Priv. Ltr. Rul. 9416043, 1994 WL 141568 (Jan. 28, 1994)

IRS Priv. Ltr. Rul. 8044074, 1980 WL 135505 (Aug. 11, 1980)

t to Rule 19(a) of the Federal Civil Procedure. However, Rule) requires joinder only when the e of the unjoined party prevents e relief among the current par- LC, PBGC and Centerre. The is on relief between the parties t on the speculative possibility of litigation between a party and nt person. *Morgan Guaranty Co. v. Martin*, 466 F.2d 593, 598-99 ir. 1972). The resolution of the LLC's right to the possession of row fund without government erence will result in complete re- tween the present parties.

er, the provisions of Rule do not require the joinder of the articipants. The resolution of this will not impair the employees' o sue LLC if they believe they tled to more money. *See New nd Patriots Football Club, Inc. v. rsity of Colorado*, 592 F.2d 1196, t Cir. 1979). The likelihood of its is remote; during the pro- d period of this litigation no em- has attempted to become a party. lution likewise does not subject a substantial risk of inconsis- bligations because PBGC is under y to litigate ERISA provisions for efit of plan participants. *See* 29 1303(f). Centerre is a disinter- stakeholder who will be releasing nds as directed in a valid court d who therefore has no substan- of inconsistant obligations. LLC ing to bear the remote risk of onal lawsuits by employees. The scussion reveals that the district d not err in refusing to join the articipants pursuant to Rule 19. ght of our earlier ruling that LLC ed to the escrow funds without ence by PBGC, it is unnecessary ress PBGC's second issue on cross- l concerning the appropriate in- arned by the employees on the unds.

reverse the judgment of the dis- ourt in part and remand for the an order consistent with this

DONOVAN v. WILLIAMS

**U.S. District Court,
Northern District of Ohio,
Eastern Division**

RAYMOND J. DONOVAN, Secretary of the United States Department of Labor, v. PHIL WILLIAMS, et al., No. C 78-82 Y, Feb. 2, 1983.

ERISA — PROTECTION OF RIGHTS

Definitions — Fiduciary ► 5.31)

[1] Union official who had discretionary authority over benefit plan assets through assumption of control over plan accounts, and who also had power to appoint and remove plan fiduciaries, was ERISA plan fiduciary although not so designated, since ERISA Section 3(21) defines term not only with reference to specifically designated fiduciary positions such as trustee and plan administrator, but also with reference to functional realities.

Fiduciary Responsibility — Fiduciary Duties — Exclusive Purpose (► 20.210)

Fiduciary Responsibility — Fiduciary Duties — Prudence Standard (► 20.225)

[2] Union official, who also was fudiciary of five benefit plans, violated exclusive purpose and prudence standards for fiduciary conduct under ERISA Section 404(a)(1) by facilitating or causing diversions of plan assets to union parties in interest, and by failing to take adequate steps to transmit monies due and owing to plans, which employers had paid to unions.

Fiduciary Responsibility — Liability for Co-fiduciary Breaches — In General (► 20.301)

[3] Benefit plan fiduciary who failed to make reasonable efforts to correct wide range of breaches committed by co-fiduciary and others is liable for such violations as co-fiduciary, since his knowledge of finances, operations, and bank accounts of plans and related unions was sufficient to establish type of knowledge required for violations of ERISA Section 405(a)(3).

Fiduciary Responsibility — Prohibited Transactions — Act on Behalf of Adverse Party (► 20.425)

[4] Union official, who also was fiduciary of five benefit plans, violated ERISA Section 406(b) prohibition against acting on behalf of parties with interests adverse to those of plans by remitting to union monies that should have gone to plans, by failing to remit sufficient amounts from union collection account to plans, and by failing to take steps to recover debts owed by union to plans.

Fiduciary Responsibility — Liability for Breach — In General (► 20.651)

Administration and Enforcement — Remedies — In General (► 40.201)

[5] Union official and fiduciary of five benefit plans, who breached ERISA's fiduciary responsibility provisions, is jointly and severally liable to plans for financial losses from time he became fiduciary until time court-appointed receiver resumed his responsibilities, and for amounts owed plans that he failed, without justification, to collect when he first became plan fiduciary; he also is enjoined from serving in future as fiduciary for any ERISA-covered plan.

Action by U.S. Department of Labor alleging breaches of fiduciary duties by fiduciaries of five employee benefit plans. Judgment against single fiduciary defendant remaining in action; claims against other defendants resolved through consent orders, entry of sanctions, or entry of default judgment.

James B. Petrick and Samuel Halpern, Office of the Solicitor, Plan Benefits Security Division, U.S. Department of Labor, Washington, D.C., attorneys for Donovan.

Harold Felger, pro se, of Youngstown, Ohio.

Full Text of Opinion

LAMBROS, District Judge.

I. *INTRODUCTION*

This above-captioned action was filed on May 8, 1978 by plaintiff, the Secretary of the United States Department of Labor, pursuant to Title I of the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. §1001, *et seq.* The complaint alleged that the fiduciaries of five employee benefit plans maintained by the Associated Trades and Crafts National Union (ATC or the National Union) and the Associated Trades and Crafts Local Union No. 2 (Local 2) violated their fiduciary duties under ERISA by mismanaging or permitting others to mismanage plan assets entrusted to them, and by diverting or permitting the diversion of such assets for the benefit of ATC, Local 2, and other parties in interest in violation of the fiduciary responsibility provisions of ERISA. The complaint also alleged violation of ERISA's requirements concerning fiduciary bonding, and concerning reporting and disclosure of financial and other information regarding the assets and operations of the plans.

Named as defendants were persons or entities who allegedly served as fiduciaries to one or more of the plans at issue, or who were parties in interest to the plans, as discussed more fully below. Plaintiff's claims against all defendants except Harold Felger have been resolved by way of various consent orders, or entry of sanctions under Rule 37, F.R.C.P., or entry of default judgment under Rule 55.

Trial in this case was held on May 4 and 6, 1982, and focused primarily on the allegations of fiduciary breach asserted against defendant Felger. Based on the evidence received at that trial and all matters of record in this proceeding, the Court hereby makes the following findings of fact.

II. *FINDINGS OF FACT*

A. *The Unions and the Plans*

1. ATC and Local 2 were both unaffiliated labor organizations headquartered in Youngstown, Ohio. Trial Exhibits (Exhs.) 1, 2, 3, 13, 15. These unions bargained with an employer organization in the Youngstown area known as the United Contractors Association (UCA). Transcript of Trial Testimony of John Esposito, p. 60, 61 (Tr. Esposito); Exh. 4. Throughout the early and mid-1970's, UCA and ATC were signatories to collective bargaining agreements which provided for funding certain of the employee benefit plans here at issue. Exh. 4.

2. At all times after January 1, 1975, defendant Phil Williams was President of ATC and as such, presided over all sessions of the ATC National Executive Committee. *See, e.g.,* Exhs. 16, 24, 26A-J, 51, 71. That Committee was responsible for enforcing the ATC Constitution, and generally directing the affairs of the ATC. Exh. 1.

3. Defendant Harold Felger served as Secretary-Treasurer of ATC, beginning in December 1975. Tr. Harold Felger, May 6, 1982, p. 196; Exh. 56. Mr. Felger never formally resigned from that position. Deposition Felger, Aug. 29, 1979, p. 9. As Secretary-Treasurer he was chief financial officer of the ATC, responsible for receiving and collecting all monies due to the National Union, maintaining all financial books and records, and issuing quarterly financial reports on the operations of the Union. Exh. 1. He also served on the National Executive Committee. Exhs. 56, 57, 59.

4. During the early 1970's ATC and Local 2 established five employee benefit plans to provide pension, health and welfare, apprenticeship training, vacation, and prepaid legal service benefits to participants. Exhs. 5A-D, 6, 7, 8, 9. The pension, health and welfare, and apprenticeship plans were jointly trusteed by representatives of labor and management and were funded by employer contributions. Exhs. 5A-D, 7, 8. The vacation and prepaid legal services plans were operated by trustees appointed only by the union and were funded solely by voluntary deductions from employees' wages. Exhs. 6, 9. The vacation plan covered only Local 2 members; all of the other plans covered members of the National Union and Local 2, which members collectively numbered

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5. The Associated Trades a
National Union Pension Plar
plan) was adopted on Februar
pursuant to a collective l
agreement with UCA. Exh. 5.
March 1977, subscribing
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each covered employee. *Id.* T
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Williams, Don McGaughy, Fre
Richard Oxley, and Ralph
See Court Order, March 13,
swers of defendants McGaug
and Mansfield to Plaintiff's In
ry #1 and #2 (Answers to In
ry #1 and #2).

6. The Associated Trades
Ohio Trust Fund (the health
fare plan) was instituted in
1970. It was maintained pur
collective bargaining agreer
UCA and, as of March 1977, v
by $.40 per hour contribut
signatory employers. Exh. 8.
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health and welfare plan afte
1, 1975: Phil Williams, Davi
David George, Frank Czako,
sito, Richard Oxley, Don
and John Sikora III. *See* Co
March 13, 1981; Answers to I
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and Associates, Inc., an insur
cy, solicited bids and purcha
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commissions for that work.
of Leroy Slusser, pp. 40-41
Answer to Interrogatory #1
C. Thomas and Associates als
insurance claims for plan p
Slusser Depo., p. 42.

7. The Associated Trades
National Apprenticeship Pla
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for each hour worked by men
union. Exh. 7. The following
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82, p. 196; Exh. 56. Mr. Felger
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position Felger, Aug. 29, 1979, p.
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ee. Exhs. 56, 57, 59.

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pants. Exhs. 5A-D, 6, 7, 8, 9.
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ontributions. Exhs. 5A-D, 7, 8.
ion and prepaid legal services
operated by trustees appoint-
y the union and were funded
y voluntary deductions from
wages. Exhs. 6, 9. The vaca-
overed only Local 2 members;
other plans covered members
National Union and Local 2,
mbers collectively numbered

between two and three hundred. Exh. 15.

5. The Associated Trades and Crafts National Union Pension Plan (pension plan) was adopted on February 28, 1973, pursuant to a collective bargaining agreement with UCA. Exh. 5A-D. As of March 1977, subscribing employers were required to contribute to the pension plan $.30 for each hour worked by each covered employee. *Id.* The following persons served as pension plan trustees at various times after January 1, 1975, the effective date of ERISA : Phil Williams, Don McGaughy, Frank Czako, Richard Oxley, and Ralph Mansfield. *See* Court Order, March 13, 1981; Answers of defendants McGaughy, Czako, and Mansfield to Plaintiff's Interrogatory #1 and #2 (Answers to Interrogatory #1 and #2).

6. The Associated Trades and Crafts Ohio Trust Fund (the health and welfare plan) was instituted in September 1970. It was maintained pursuant to a collective bargaining agreement with UCA and, as of March 1977, was funded by $.40 per hour contributions from signatory employers. Exh. 8. The following defendants served as trustees of the health and welfare plan after January 1, 1975: Phil Williams, David R. Best, David George, Frank Czako, John Esposito, Richard Oxley, Don McGaughy, and John Sikora III. *See* Court Order, March 13, 1981; Answers to Interrogatory #1 and #2. Defendant C. Thomas and Associates, Inc., an insurance agency, solicited bids and purchased insurance on behalf of the plan and received commissions for that work. Deposition of Leroy Slusser, pp. 40-41; Slusser's Answer to Interrogatory #13. For a fee C. Thomas and Associates also processed insurance claims for plan participants. Slusser Depo., p. 42.

7. The Associated Trades and Craft National Apprenticeship Plan (apprenticeship plan) provided benefits in the form of payments for course materials from correspondence schools. As of March 1977, employers contributed $.05 for each hour worked by members of the union. Exh. 7. The following defendants served as trustees of the apprenticeship plan after January 1, 1975: Phil Williams, Don McGaughy, Frank Czako, Richard Oxley, and Ralph Mansfield, *See* Court Order, March 13, 1981; Answers to Interrogatory #1 and #2.

8. The Associated Trades and Crafts National Prepaid Legal Services Plan (legal services plan), funded by $.08 per hour employee contributions, provided benefits under the terms of a contract between the plan trustees and a local law firm. Exh. 6. Defendants Williams and Oxley served as trustees of this plan after January 1, 1975. *See* Court Order, March 13, 1981.

9. The Associated Trades and Crafts National Union and Local 2 Vacation Trust (vacation plan) was created in or about January 1971. The vacation plan was funded by $.30 per hour employee contributions withheld by the employers and remitted together with employer contributions for the pension, health and welfare, and apprenticeship plans. Exh. 9; Tr. Felger, p. 174.

B. *The Manner of Payment of Contributions to the Plans*

10. Prior to January 1976, and in accordance with the terms of applicable collective bargaining agreements, signatory employers remitted a single check each month to either Local 2 or ATC, depending on the entity of which their respective employees were members. These checks included payment for union dues and assessments as well as benefit plan contributions and deductions. The unions were then responsible for allocating and transferring to the respective plans the amounts received on behalf of each. Tr. Felger, pp. p. 174; Tr. Esposito, pp. 62-4.

11. By December 1975, Local 2 had received $85,915 in employer contributions that it failed to remit to the plans. Exhs. 14, 18.

12. In January 1976, the existing system for payment of contributions to the plans was altered when the ATC National Executive Committee, including defendants Williams and Felger, imposed a trusteeship on Local 2. The stated purpose of the trusteeship was to impose controls over the finances of Local 2 and to take steps toward repay-

ment of the amounts of plan money improperly retained by Local 2. Exhs. 14, 57, 59; Tr. Felger, pp. 206-07. The Executive Committee appointed a Mr. John Daily as trustee over the financial affairs of Local 2 and the plans, and Daily served in that role until June 1976. Exhs. 57, 59, 70; Tr. Felger, p. 207. During Daily's tenure, all employer contributions were deposited in a collection account, established by Daily, where the contributions were then supposed to be allocated and transferred to the appropriate plan accounts. Tr. Felger, pp. 207-210.

C. *The role of Defendant Felger*

At trial, defendant Felger maintained that he was, at all relevant times, merely a "custodian" for the assets of the plans, and not a fiduciary as defined in §3(21)(A) of ERISA, 29 U.S.C. §1002(21)(A). *See* Tr. Felger, pp. 227. Regarding that issue, the Court finds the following facts:

13. Prior to 1975, Felger was employed as a public accountant for various corporate and individual clients. During that period, he prepared the personal tax returns of Williams. In mid-1975, Williams requested Felger to perform an audit of Local 2 and of ATC, and Felger thus gained access to the books and records of the plans and unions. Tr. Felger, pp. 167-71.

14. By letter dated October 31, 1975, attorney Richard McLaughlin informed Felger, Williams, and others of the legal obligation to correct the retention by Local 2 of money owed to the plans. Exh. 67; Tr. Felger, pp. 187-90. Thereafter the ATC National Executive Committee, including Felger, arranged for execution of unsecured, demand promissory notes from Local 2 to each of the plans in the total amount of $80,050. Tr. Felger, pp. 191-93. Exh. 22A-E. The National Executive Committee also, in January, 1976 imposed the aforementioned trusteeship over Local 2 and oversaw establishment of the collection account. Exhs. 14, 57, 59. Defendant Felger nominated Mr. Daily as trustee over Local 2 and the collection account. Exh. 57; Tr. Felger, p. 207.

15. Daily resigned by letter dated June 21, 1976, addressed to Felger and Williams. Exh. 70. By no later than June 21, 1976, Felger, along with Williams, possessed authority to draw checks on the accounts of Local 2, the collection account, and the plans. Tr. Felger, pp. 243, 250-51; Exhs. 26A-J, 27-34. Only two people — Williams and Felger — held check-writing authority over the collection account, and both signatures were required to make withdrawals. Tr. Felger, pp. 241-43.

16. Over the years that Williams and Felger controlled the collection account, the amounts of money owed by that account to the plans, but never transferred, increased significantly; and the amounts paid by the collection account to ATC, in excess of amounts actually due to ATC, likewise increased. Exhs. 19, 20A-E; Tr. Allyn Adams, May 6, 1982, pp. 320-22.

17. As for the bank accounts of the plans, Williams, Felger, and a third-person named Donald Hanni were listed on the signature cards, and the combined signatures of any two of them were required for a withdrawal. Exhs. 26A-J; Tr. Felger, pp. 227-32, 239. Felger obtained check-writing authority over the plan accounts in May 1976. Exh. 26A, B, C, H, J. All checks drawn on the plans which were received in evidence bore the signatures of Williams and Felger. Exhs. 27-32. Felger testified that he executed such checks solely on the instructions of defendant Williams or other trustees, but could not provide any written proof to substantiate that claim. Tr. Felger, pp. 232-34, 240-41.

18. Felger conceded that he never attempted in conjunction with Hanni to prevent Williams from writing checks on the bank accounts of the plans and never refused Williams' requests to sign such checks. Tr. Felger, pp. 239-40, 255-59. Felger also testified that there were no documents, apart from signature cards for the plans' bank accounts, that established or circumscribed his authority over disposition of plan assets. Tr. Felger, p. 234.

19. A number of checks introduced in evidence demonstrate that Felger, along

with Williams, drew ch
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Local 2. Exhs. 27-29, 3
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20. As Secretary-Tre
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21. From at least Ju
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22. In September 1
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ily resigned by letter dated 1976, addressed to Felger and Exh. 70. By no later than 1976, Felger, along with Wil- possessed authority to draw n the accounts of Local 2, the account, and the plans. Tr. 243, 250-51; Exhs. 26A-J, 27- two people — Williams and held check-writing authority collection account, and both were required to make with- Tr. Felger, pp. 241-43.

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or the bank accounts of the illiams, Felger, and a third-per- d Donald Hanni were listed on ure cards, and the combined of any two of them were for a withdrawal. Exhs. 26A-J; r, pp. 227-32, 239. Felger ob- k-writing authority over the nts in May 1976. Exh. 26A, B, All checks drawn on the plans ere received in evidence bore ures of Williams and Felger. 2. Felger testified that he such checks solely on the in- s of defendant Williams or oth- , but could not provide any of to substantiate that claim. r, pp. 232-34, 240-41.

lger conceded that he never in conjunction with Hanni to illiams from writing checks ank accounts of the plans and used Williams' requests to sign s. Tr. Felger, pp. 239-40, 255- also testified that there were nents, apart from signature the plans' bank accounts, that or circumscribed his author- sposition of plan assets. Tr. 234.

umber of checks introduced in monstrate that Felger, along

with Williams, drew checks from the bank accounts of the plans, payable to parties in interest such as ATC and Local 2. Exhs. 27-29, 31, 32. Over the years that Felger possessed and exercised check-writing authority over the bank accounts of the plans, the amounts receivable by each of the plans from Local 2 continually increased. Exh. 20A-E.

20. As Secretary-Treasurer of ATC, and along with other members of the National Executive Committee, defendant Felger possessed power to suspend and expel members of ATC and Local 2 from the unions. Exhs. 1 and 2. In October 1977, Felger, along with defendants Williams and McGaughy, exercised that power by suspending and later expelling defendant Mansfield from membership in the unions. Exh. 71. Mansfield was, until the time of his expulsion from the unions, a fiduciary of the pension and apprenticeship plans. Once expelled from the unions, he no longer was entitled to serve, and did not serve, as a fiduciary of any ATC plan. Mansfield Answers to Interrogatory #1, #14(e)(ii). Depo. Ralph Mansfield, Aug. 29, 1979, 67-70.

21. From at least June 1976 onward, Felger maintained possession of the financial records of the plans, either at the ATC offices in Youngstown or at his own home. Tr. Felger, pp. 251-55.

22. In September 1977, several trustees of the plans, including defendants Czako and Speece and Steven Mosesson, a witness at trial, visited Mr. Felger at his home and requested access to the financial books and records of the plans. Tr. Mosesson, pp. 113-20; Tr. Felger, p. 266. Felger testified that he believed all three men were indeed trustees of the plans and that they had a legal right to see the books and records, but told them that the documents were at the ATC offices. Tr. Felger, pp. 266-68. Based on the trial testimony and interrogatory answers of defendants Felger and Mosesson, and the deposition testimony of defendants Czako and Speece, the Court finds that Felger promised the three trustees access to the books and records, but later, at the direction of Williams, failed and refused to provide such access. Despite his knowledge as an accountant and as the person in charge of the financial records of the plans, unions, and collection account, Felger never supplied information to the trustees and never provided them access to the records in an effort to collect the assets owed to the plans. *See* Tr. Mosesson, pp. 113-20; 124-25; 130-31; Tr. Felger, pp. 266-71; Czako and Esposito Answers to Interrogatory 14(c)(ii); Tr. Esposito, pp. 65-66.

D. *Losses to the Plans and Efforts at Recovery*

23. The primary proof at trial regarding the financial losses suffered by the five ATC plans was provided through the financial schedules compiled by Mr. Allyn Adams. Exh. 20A-E. In August 1978, this Court, through entry of a Consent Order, appointed a receiver to assume control over the operations and assets of the five plans;[1] and the receiver thereafter selected Mr. Adams as his accountant to review the books and records of the plans. Tr. Adams, pp. 298-300. Mr. Adams, a certified public accountant and partner at the accounting firm Deloitte, Haskins, and Sells, testified at trial regarding the schedules he compiled and other work he performed for the receiver. *Id.*, p. 293. The Court found Mr. Adams highly qualified and competent to perform the work requested by the receiver, and found him to be a credible and articulate witness. The fairness and accuracy of the schedules prepared by Mr. Adams were not challenged by any defendant, and the Court accepts them as fair and accurate compilations of the financial condition of each plan, on a quarterly basis from December 31, 1975 through December 31, 1980.

24. Based on the financial schedules prepared by Mr. Adams, the Court finds that as of the dates set forth below, the collection account owed the respective plans the following amounts of money:

[1] The receiver disclosed at trial, however, that he never obtained control over the collection account.

PLAN	12/31/75	6/30/76	6/30/78	12/31/80
Pension:	$0	$5,518	$45,056	$44,989
Health & Welfare:	0	4,650	0	0
Vacation:	0	239	0	0
Prepaid Legal Services:	0	815	2,117	2,176
Apprenticeship:	0	1,065	7,623	6,499

25. The foregoing chart demonstrates that from the time Felger first gained check-writing authority over the plans and collection account (shortly before June 30, 1976), until the time the Court-appointed receiver assumed his duties (shortly after June 30, 1978), the aggregate balance owed by the collection account to the plans substantially increased. The aggregate outstanding balance totalled $53,664.00 as of December 31, 1980, exclusive of interest, and the balance has remained undiminished since that time.

26. At least some of the money owed by the collection account to the plans was paid instead to ATC. As of June 30, 1976 — just after Felger and Williams assumed control over the collection account — that account had paid ATC approximately $500 more than the amount actually due to ATC. By June 30, 1978, the amount of excess payments to ATC had risen to over $28,000. Since that time, that amount has remained undiminished. Exh. 19; Tr. Adams, pp. 321-22; Felger Answer to Interrogatory #5(c).

27. As of December 31, 1980, the collection account carried a cash balance of $11,982, available for application against the amounts owed to the plans. Tr. Adams, pp. 335, 338-39.

28. As of the dates set forth below, Local 2 owed the respective plans at least the following amounts of principal and interest:

PLAN	12/31/75	6/30/76	6/30/78	12/31/80
Pension:	$35,000 principal/500 interest	$35,000/1,900	$35,813/8,200	$35,813/14,500
Health & Welfare:	$ 5,000/70	$5,000/270	$5,000/1,070	$6,633/2,070
Vacation:	$30,000/400	$30,000/1,600	$30,000/6,400	$30,000/12,400
Prepaid Legal Services:	$ 3,000/40	$3,000/160	$3,000/640	$3,216/1,240
Apprenticeship:	$ 7,500/100	$7,500/400	$7,500/1,600	$7,623/3,100

29. The foregoing chart demonstrates that since the date Daily resigned and Williams and Felger succeeded him, the amount of principal owed by Local 2 to the plans remained undiminished and the amount of interest owed continually increased. As of December 31, 1980, the aggregate amount of principal and interest owed by Local 2 to the plans was $116,595.00 and that amount has remained undiminished since that time.

30. Defendant Felger testified that on occasion he asked the president of Local 2, defendant Oxley, whether the Local would pay its debt, and further testified that even if he (Felger) had demanded payment, such payment could not have been made. Tr. Felger, pp. 195-96. However, Felger never brought suit against defendants Williams, Local 2, or ATC, never sought to collateralize the amounts owed to the plans by Local 2 and the collection account, never showed the promissory notes from Local 2 to trustees other than Williams and Oxley, and deprived trustees who sought to remedy the situation access to plan records. Tr. Felger, pp. 194, 198, 271.

31. Prior to the time Felger became Secretary-Treasurer of ATC in Decem-

ber 1975, the health and
paid out a total of $8,500
advances to C. Thomas an
in addition to commissions
October 10, 1975, C. Thom
ciates issued the plan an $
sory note, which was ur
payable on demand, and

12/31/75	6/30/
$8,500 principal/100 interest	$8,50

33. Defendant Felger te
never took steps to demar
the principal or interest
Thomas note or to obtain
the note. Tr. Felger, pp. 26

34. In addition to loss
the plans have suffered t
instruments purchased b
vestments. Prior to Nove
several of the plans at i
chased a total of $47,7
bearing promissory note
Associates First Capital C
November 26, 1975, defer
pledged these notes to S
Eastern Ohio, formerly P
Youngstown, as collater
Local 2. Exhs. 24, 25. A
trial, the receiver was in
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and accrued interest. Tr
erdank, pp. 346-48. It nc
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least some of the princi
at issue. The total princi
at issue is at least $65,85
25.

35. Defendant Felge
after becoming Secreta
ATC, he learned in
Williams had pledged
by the plans. Tr. Felger,

F. *Reporting*

36. None of the five
filed, or had filed or
annual report, Form 5
29 U.S.C. §1023(a). Exh

37. The health and
apprenticeship plan n
filed on their behalf,
tion, Form EBS-1, a
U.S.C. §1022. Exh. 11.

6/30/78	12/31/80
$45,056	$44,989
0	0
0	0
2,117	2,176
7,623	6,499

— that account had paid ATC imately $500 more than the actually due to ATC. By June the amount of excess payments had risen to over $28,000. Since me, that amount has remained ished. Exh. 19; Tr. Adams, pp. Felger Answer to Interrogatory

s of December 31, 1980, the n account carried a cash bal- $11,982, available for applica- gainst the amounts owed to the . Adams, pp. 335, 338-39.

of the dates set forth below, 2 owed the respective plans at ie following amounts of principal rest:

6/30/78	12/31/80
$35,813/8,200	$35,813/14,500
$5,000/1,070	$6,633/2,070
$30,000/6,400	$30,000/12,400
$3,000/640	$3,216/1,240
$7,500/1,600	$7,623/3,100

n if he (Felger) had demanded nt, such payment could not have ade. Tr. Felger, pp. 195-96. How- ger never brought suit against ts Williams, Local 2, or ATC, sought to collateralize the ts owed to the plans by Local 2 e collection account, never he promissory notes from Local ustees other than Williams and nd deprived trustees who sought ly the situation access to plan Tr. Felger, pp. 194, 198, 271.

rior to the time Felger became y-Treasurer of ATC in Decem-

ber 1975, the health and welfare plan paid out a total of $8,500 in unsecured advances to C. Thomas and Associates, in addition to commissions and fees. On October 10, 1975, C. Thomas and Associates issued the plan an $8,500 promissory note, which was unsecured and payable on demand, and which bore interest at 8 percent annually. Exhs. 20B, 23.

32. Based on the financial schedule, Exh. 20B, the amount of principal and interest owed by C. Thomas and Associates to the health and welfare plan (but never received by the plan) as of various dates, was as follows:

12/31/75	6/30/76	6/30/78	12/31/80
$8,500 principal/100 interest	$8,500/270	$8,500/1800	$8,500/3,500

33. Defendant Felger testified that he never took steps to demand payment of the principal or interest due on the C. Thomas note or to obtain collateral for the note. Tr. Felger, pp. 265-66

34. In addition to loss of cash assets, the plans have suffered the loss of debt instruments purchased by them as investments. Prior to November of 1975, several of the plans at issue here purchased a total of $47,750 in interest-bearing promissory notes issued by the Associates First Capital Corporation. On November 26, 1975, defendant Williams pledged these notes to Society Bank of Eastern Ohio, formerly People's Bank of Youngstown, as collateral for a loan to Local 2. Exhs. 24, 25. As of the date of trial, the receiver was in litigation with the bank as to ownership of the notes and accrued interest. Tr. Lawrence Oberdank, pp. 346-48. It now appears that the receiver will ultimately recover at least some of the principal and interest at issue. The total principal and interest at issue is at least $65,850.00. Exhs. 20A, 25.

35. Defendant Felger testified that after becoming Secretary-Treasurer of ATC, he learned in April 1976 that Williams had pledged the notes owned by the plans. Tr. Felger, p. 264.

F. *Reporting*

36. None of the five ATC plans ever filed, or had filed on its behalf, an annual report, Form 5500, as defined in 29 U.S.C. §1023(a). Exh. 10.

37. The health and welfare plan and apprenticeship plan never filed, or had filed on their behalf, any plan description, Form EBS-1, as defined in 29 U.S.C. §1022. Exh. 11.

Based upon the foregoing findings of fact, this Court makes the following conclusions of Law.

III. *CONCLUSIONS OF LAW*

1. This Court has jurisdiction over this action pursuant to 29 U.S.C. §1132(e)(1), and venue properly lies in the Northern District of Ohio pursuant to 29 U.S.C. §1132(e)(2).

2. Each of the five ATC plans at issue in this case is an employee benefit plan within the meaning of 29 U.S.C. §1002(3).

3. ERISA is a comprehensive remedial statute designed to protect "the interests of participants in employee benefit plans and their beneficiaries ... by establishing standards of conduct, responsibility, and obligation for fiduciaries of employee benefit plans, and by providing for appropriate remedies, sanctions, and ready access to the Federal courts." 29 U.S.C. §1001(b).

4. As defined in 29 U.S.C. §1002(21)(A):

> [A] person is a fiduciary with respect to a plan to the extent (i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets, (ii) he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or (iii) he has any discretionary authority or discretionary responsibility in the administration of such plan.

[1] Based on the record established at trial, the Court concludes that defendant Felger was a "fiduciary" within the meaning of ERISA, with respect to all five of the ATC plans, beginning at least in June 1976. Because the protections of Title I of ERISA essentially arise from the responsibilities of persons deemed to be "fiduciaries," that term is defined not only with reference to specifically designated fiduciary positions such as "trustee" and "plan administrator," but also with reference to functional realities. *Fulk v. Bagley,* 88 F.R.D. 153, 161-62 (M.D. N.C. 1980); *Freund v. Marshall and Ilsley Bank,* 485 F. Supp. 629, 635 [1 EBC 1898] (W.D. Wis. 1979). The definition of a fiduciary under §1002(21) includes all persons who have any discretionary control or authority over the management, administration or assets of any employee benefit plan, whatever the title of their position. *Eaves v. Penn,* 587 F.2d 453 [1 EBC 1592] (10th Cir. 1978); *Fulk v. Bagley,* 88 F.R.D. at 161-62; *Brink v. Da Lesio,* 496 F. Supp. 1350 [2 EBC 2057] (D. Md. 1980). Whether a person is a fiduciary is to be determined according to an objective standard, regardless of the person's subjective belief as to whether he is a fiduciary. *Freund,* 485 F. Supp. at 635. When, along with Williams, defendant Felger assumed control of the collection account and plan accounts in June 1976, he gained the sort of authority over disposition of plan assets that Congress defined in §1002(21). *See Freund,* 485 F. Supp. at 634-35.

5. Further establishing Felger's control over plan assets and thus his status as a fiduciary is the power he held to appoint and remove other fiduciaries, such as Messrs. Daily and Mansfield. Such power to choose plan trustees and fiduciaries itself made Felger a plan fiduciary. *Eaves v. Penn,* 587 F.2d at 458; *Freund v. Marshall and Ilsley Bank,* 485 F. Supp. at 640-641; *Fulk v. Bagley,* 88 F.R.D. at 161-162.

6. The central and fundamental obligation imposed on all fiduciaries by ERISA is that they must discharge their duties "solely in the interest of participants and beneficiaries and — "

(A) for the exclusive purpose of:
(i) providing benefits to participants and their beneficiaries; and
(ii) defraying reasonable expenses of administering the plan;
(B) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;

29 U.S.C. §1104(a)(1)(A)-(B).

[2] 7. Defendant Felger violated his fiduciary duties under 29 U.S.C. §1104(a)(1)(A) and (B) with respect to all the benefit plans both by facilitating or causing diversions of plan assets or by failing to take adequate steps to collect monies due and owing to the plans. Courts have repeatedly recognized breaches under §1104(a)(1) when fiduciaries themselves mismanage or divert plan assets to parties-in-interest, *see, e.g., Marshall v. Snyder,* 430 F. Supp. 1224 (E.D. N.Y. 1977) *aff'd* 572 F.2d 894 [1 EBC 1573] (2d Cir. 1978); *Eaves v. Penn,* 587 F.2d at 455; *Mahoney v. Union Leader Retirement Profit Sharing Plan,* 635 F.2d 27 [1 EBC 2127] (1st Cir. 1980), and when fiduciaries fail to take sufficient steps to collect amounts owed to a plan, *see e.g., Marshall v. Kelly,* 465 F. Supp. 341 [1 EBC 1850] (W.D. Okla. 1979); *Freund v. Marshall and Ilsley Bank,* 485 F. Supp. at 634-35.

8. Supplementing the duties of §1104 are the duties of co-fiduciaries under 29 U.S.C. §1105(a). Section 1105(a) provides:

In addition to any liability which he may have under any other provision of this part . . . a fiduciary with respect to a plan shall be liable for a breach of fiduciary responsibility of another fiduciary with respect to the same plan in the following circumstances:

. . .

(3) if he has knowledge of a breach by such other fiduciary, unless he makes reasonable efforts under the circumstances to remedy the breach.

[3] 9. Defendant Felger maintained at trial that he acted at the direction of defendant Williams. Notwithstanding

the truth of this position, nonetheless liable as a co-fidu der §1105(a)(3) due to his make reasonable efforts to c wide range of breaches com Williams and others. *See*] History of the Employee F Income Security Act of 1974, 93-533, 94th Cong., 2d Sess., r [1974] U.S. Code Cong. & Ad.] 51; *Freund,* 485 F. Supp. at 64 *supra,* 88 F.R.D. at 160-161; *M Craft,* 463 F. Supp. 493 (N.D. Felger's detailed knowledge nances and operations of the account, bank accounts of the unions was sufficient to es type of knowledge required tion of §1105(a)(3).

10. Felger further violated ciary duty under §1105(a) b ensure that the plans compli reporting and disclosure pr ERISA. By failing to file th financial reports and plan d the plans and plan administ ed 29 U.S.C. §§1023(a) a Given his unique responsibil knowledge of the financial] plans, and his failure to trustees access to those b was especially obligated to in lation and filing of the st quired reports.

11. ATC, Local 2 and C. Associates were all partie with respect to the plans. A 2 were parties-in-interest plans because they both we organizations whose membe ered by the plans. §1002(14)(D). C. Thomas ar was a party-in-interest to th welfare plan because it w providing services to an em fit plan within the meanin §1002(14)(B).

12. As a fiduciary of a Felger was charged with] the unions and C. Thom ciates were parties-in-inte *shall v. Kelly,* 465 F. S *Freund v. Marshall and Ils* F. Supp. at 637.

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the truth of this position, Felger is nonetheless liable as a co-fiduciary under §1105(a)(3) due to his failure to make reasonable efforts to correct the wide range of breaches committed by Williams and others. *See* Legislative History of the Employee Retirement Income Security Act of 1974, H.R. Rep. 93-533, 94th Cong., 2d Sess., *reprinted in* [1974] U.S. Code Cong. & Ad. News 4650-51; *Freund,* 485 F. Supp. at 640-41; *Fulk, supra,* 88 F.R.D. at 160-161; *Marshall v. Craft,* 463 F. Supp. 493 (N.D. Ga. 1978). Felger's detailed knowledge of the finances and operations of the collection account, bank accounts of the plans, and unions was sufficient to establish the type of knowledge required for a violation of §1105(a)(3).

10. Felger further violated his co-fiduciary duty under §1105(a) by failing to ensure that the plans complied with the reporting and disclosure provisions of ERISA. By failing to file the necessary financial reports and plan descriptions, the plans and plan administrator violated 29 U.S.C. §§1023(a) and 1024(a). Given his unique responsibilities for and knowledge of the financial books of the plans, and his failure to provide the trustees access to those books, Felger was especially obligated to insure compilation and filing of the statutorily-required reports.

11. ATC, Local 2 and C. Thomas and Associates were all parties-in-interest with respect to the plans. ATC and Local 2 were parties-in-interest to all five plans because they both were employee organizations whose members were covered by the plans. 29 U.S.C. §1002(14)(D). C. Thomas and Associates was a party-in-interest to the health and welfare plan because it was a person providing services to an employee benefit plan within the meaning of 29 U.S.C. §1002(14)(B).

12. As a fiduciary of all five plans, Felger was charged with knowing that the unions and C. Thomas and Associates were parties-in-interest. *See Marshall v. Kelly,* 465 F. Supp. at 354; *Freund v. Marshall and Ilsley Bank,* 485 F. Supp. at 637.

13. Through his control over the plan and collection accounts, Felger not only permitted past transfers to these parties-in-interest to remain uncured, but also participated in further prohibited transfers, contrary to 29 U.S.C. §1106(a)(1)(D), by permitting plan assets to be transferred to, or used by or for the benefit of the unions and C. Thomas and Associates. *See, e.g., Marshall v. Kelly,* 465 F. Supp. at 354.

[4] 14. Acting as both Secretary-Treasurer of ATC and a plan fiduciary, defendant Felger also violated 29 U.S.C. §1106(b) by acting on behalf of the unions — parties whose interests were adverse to those of the plans — rather than on behalf of the five plans which he served as fiduciary. Felger's ongoing participation in remitting money to Local 2, rather than to the plans, his failure to remit sufficient amounts from the collection account to the plans, and his failure to take steps to recover the debts owed to the plans all worked to the benefit of the unions, contrary to §1106(b). *Freund,* 485 F. Supp. at 637-40. *Gilliam v. Edwards,* 492 F. Supp. 1255, 1263 [2 EBC 2475] (D. N.J. 1980).

15. In enacting ERISA, Congress granted the courts broad equitable and legal powers to remedy breaches of fiduciary duties and to safeguard employee benefit plan assets against future or continuing breaches by errant fiduciaries. *Eaves v. Penn,* 587 F.2d at 462; *Marshall v. Kelly,* 465 F. Supp. at 354. It is provided in 29 U.S.C. §1109(a) that:

> Any person who is a fiduciary with respect to a plan who breaches any of the responsibilities, obligations, or duties imposed upon fiduciaries by this title shall be personally liable to make good to such plan any losses to the plan resulting from each such breach, and to restore to such plan any profits of such fiduciary which have been made through use of assets of the plan by the fiduciary, and shall be subject to such other equitable or remedial relief as the court may deem appropriate, including removal of such fiduciary.

Pursuant to this section, and the common law of trusts, the guiding principle

in ordering relief under ERISA is to shape the relief most favorable to the plan. *Eaves v. Penn*, 587 F.2d at 462-63; *Freund*, 485 F. Supp. at 643.

[5] 16. Pursuant to 29 U.S.C. §1109, defendant Felger is jointly and severally liable for financial losses incurred by the five plans over the period beginning when he first became a fiduciary with respect to those plans (June 1976 at the latest) until the Court-appointed receiver assumed his responsibilities in August 1978. *See, e.g., Marshall v. Snyder*, 572 F.2d 894.

17. Felger also is jointly and severally liable for amounts that were owed to the plans on the date he first became a fiduciary, and which he thereafter, without justification, failed to collect. Where, prior to the date a fiduciary first assumes that status with respect to a plan, and there are amounts owed to the plan as a result of breaches of his predecessors, the fiduciary becomes liable for those amounts unless he can establish that (a) he took reasonable efforts under the circumstances to collect those amounts or (b) he could not have succeeded in so collecting even if he had taken reasonable efforts. As a fiduciary who assumed office after monies were owed to the plans, Felger acquired a legal duty to take reasonable steps to recognize that these amounts were improperly advanced and to take steps to collect them. *See Morrissey v. Curran*, 567 F.2d 546, 548-98 [1 EBC 1659] (2d Cir. 1977); *Fulk v. Bagley*, 88 F.R.D. at 160-1. As a co-fiduciary, Felger was obligated under §1105(a) to assert all legal claims the plans had against breaching fiduciaries.

18. In light of the above principles, defendant Felger is jointly and severally liable for the outstanding balances owed to the plans as of December 31, 1980, from the collection account, Local 2, and C. Thomas and Associates — a total of $182,259.00.

19. Because ownership of the Associates First Capital notes currently remains unresolved it is unclear the extent to which the plans will lose principle and interest that otherwise would have been obtained had the notes not unlawfully been pledged by defendant Williams. It is clear, however, that whatever amount of loss is ultimately suffered by the plans with respect to those notes, defendant Felger is jointly and severally liable for that amount because, in breach of his fiduciary duties, Felger failed to take sufficient steps to regain those notes for the plans.

20. Finally, pursuant to 29 U.S.C. §1109, the Court hereby enjoins defendant Harold Felger from serving in the future as a fiduciary of any plan covered by ERISA.

IT IS SO ORDERED.

JUDGMENT

In accordance with the findings of fact and conclusions of law issued this date, judgment is entered against defendant Harold Felger, who is jointly and severally liable in the amount of $182,259.00. Harold Felger is hereby permanently enjoined from serving as a fiduciary of any plan covered by ERISA.

IT IS SO ORDERED.

MOYERS v. BAUER MARBLE CO.

U.S. District Court, Northern District of Illinois, Eastern Division

E. JEFFERSON MOYERS, ROBERT P. LE VOY, JOSEPH KAPCHECK, JR., and FRANK P. BAUER, as Trustees of Marble Setters' Helpers and Polishers Local 102 Welfare Fund, v. FRANK P. BAUER MARBLE CO., an Illinois corporation, and FRANK P. BAUER, individually, No. 82 C15 82, Feb. 11, 1983.

ERISA — PROTECTION OF RIGHTS

Administration and Enforcement — Action for Contributions — In General (► 40.601)

[1] Trustees of welfare fund are entitled to summary judgment against corporate employer in action for unpaid contributions and liquidated damages, where it was admitted that employer was subject to collective bargaining

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Only the Westlaw citation is currently available.

United States District Court, N.D. Illinois, Eastern Division.

THE FIRST NATIONAL BANK OF CHICAGO, Plaintiff,
v.
THE RETIREMENT TRUST FOR EMPLOYEES OF STANDARD OIL CO., et al., Defendants.

No. 90 C 3981.

Dec. 27, 1991.

MEMORANDUM OPINION AND ORDER

ZAGEL, District Judge.

*1 Counterplaintiffs The Retirement Trust for Employees of the Standard Oil Company and Subsidiaries and United Food and Commercial Workers International Union--Industry Pension Fund move for summary judgment under ERISA section 404(a)(1)(D), 29 U.S.C. § 1104(a)(1)(D), alleging that counterdefendant First National Bank of Chicago breached the terms of the Declaration of Trust Agreement governing Fund F, a real estate collective investment fund, by failing to satisfy withdrawal requests within the prescribed one-year period. Because genuine issues of material fact remain, the motions are denied.

I.

First National Bank of Chicago is the trustee for Institutional Real Estate Fund F, and Standard Oil and UFCWU are participating employee pension benefit plans. [FN1] Section 6.6 of the Trust Agreement grants FNBC, as trustee, power to "retain, sell, exchange, convert, transfer, acquire, manage, change and dispose of ... the assets of [Fund F]." Because the Bank exercises authority and control over the management and disposition of the Fund's assets, it is a fiduciary within the meaning of ERISA. § 3(21)(A), 29 U.S.C. § 1002(21)(A). Participants in Fund F invest money and receive a number of units which represent their investment in the Fund. Each unit of participation in the Fund has a beneficial interest in the Fund equal to the proportion which it bears to the total units of the Fund. Section 5.2 of the Trust Agreement provides that "any request for withdrawal from ... Fund F must be received by the Trustee not later than one year prior to the valuation date of which such withdrawal is to be made; provided, however, that the Trustee in its sole discretion reserves the right to pay such withdrawal as of any earlier valuation date subsequent to such request." [FN2]

Until the late 1980's, FNBC generally paid withdrawal requests within a year, and sometimes more quickly. The commercial real estate market, however, sharply declined at that time, and withdrawal requests by Fund F participants increased. Standard Oil made an oral request for withdrawal in August of 1988, and UFCWU made a written request in November of 1988. FNBC responded in writing to Standard Oil's request in September of 1988. As of April 1, 1989, there were outstanding unfulfilled redemption requests of approximately 175.5 million dollars, from a Fund worth almost 600 million dollars.

The market value of the Fund F properties declined with the depression of the real estate market; in May, it was written down by 5.1%. Between April and October of 1989, FNBC received no new requests for withdrawal and reduced the balance of the outstanding requests to 109.2 million dollars. In October, however, the value of the remaining Fund F properties was again written down by 5.3%; the total write-down, which occurred in consultation with real estate and investment advisors to the Trustee, equalled 61.8 million dollars, over 10% of the original value of the Fund. In November, FNBC received two additional withdrawal requests and faced a balance of 135 million dollars in outstanding requests from the 530 million dollar Fund. The Trustee feared that satisfying the requests would necessitate a "fire sale" of Fund F properties in a depressed market, to the detriment of the participants' interests. After consulting with investment and legal advisors, FNBC suspended further redemptions in December of 1989 and has not paid off any requests for withdrawal since then. A Restructuring Proposal was circulated by FNBC to the participants but was not accepted unanimously, and the Comptroller refused to waive any regulations which would enable the Trustee to implement the Plan without complete consent.

*2 Counterplaintiffs Standard Oil and UFCWU argue that summary judgment is appropriate because the counterdefendant Trustee has not redeemed their requests for withdrawal within the one year period as

required by the Trust Agreement, in violation of ERISA § 404(a)(1)(D). That ERISA section requires fiduciaries to discharge their duties with respect to a plan "solely in the interest of the participants and ... (D) in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of this subchapter...." 29 U.S.C. § 1104(a)(1)(D). The counterdefendant FNBC argues that the 'insofar as consistent' language from that section, combined with the requirement that fiduciaries discharge their duties "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man ... would use" of § 404(a)(1)(B), means that it may avoid liability for not following the plan documents if it would have been imprudent to do so.

II.

Summary judgment should be granted whenever "there is no genuine issue as to any material fact and ... the moving party is entitled to a judgment as a matter of law." *Anderson v. Liberty Lobby,* 477 U.S. 242, 249 (1986). In determining whether any issues of material fact are in dispute, the Court draws all inferences from the record in the light most favorable to the non-moving party. *Bank Leumi Le-Israel, B.M. v. Lee,* 928 F.2d 232, 236 (7th Cir.1991). If a party "files a motion for summary judgment showing within its four corners entitlement to prevail, judgment must be entered 'against [the non-moving] party who fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden at trial.' " *Tatalovich v. City of Superior,* 904 F.2d 1135, 1139 (7th Cir.1990) (*quoting Celotex Corp. v. Catrett,* 106 S.Ct. 2548, 2552-53 (1986)).

III.

Standard Oil and UFCWU allege a failure to fulfill a trust agreement provision and the corresponding violation of an ERISA subsection. If FNBC had rested on its pleadings, the motions would have been granted; the counterplaintiffs have shown that FNBC is in breach of the one year withdrawal provision of the Trust Agreement. FNBC, however, has presented a prudence defense to the counterclaims at issue. It has argued that the prudence requirement in ERISA forced it to breach the actual terms of the plan document in order to protect the beneficial interests of the participants, and it has alleged specific facts about the prevailing market forces and the financial pressures of Fund withdrawal requests which support its claim.

FNBC argues that § 1104(a)(1)(D) does not require blind adherence to the trust documents. Rather, ERISA demands that fiduciaries act in the interests of the plan participants, with care and prudence under the circumstances, according to the documents as long as that is consistent with ERISA's other strictures. Faced with withdrawals totalling over 25% of the Fund's market value, FNBC weighed the need to raise cash quickly against the need to protect the participants' beneficial interest in the Fund. It consulted with legal and investment advisors to choose the best course of action. In order to satisfy the outstanding withdrawal requests within the one year period, FNBC would have had to sell properties worth millions of dollars for a price lowered by both time constraints and the depressed market. This process, arguably, would have lowered the value of all units in Fund F, even the units of withdrawing participants whose requests induced the sales. FNBC makes a sufficient showing that paying off the outstanding withdrawal requests, even of those participants who filed requests as early as the counterplaintiffs, would not have met ERISA standards of prudence under the prevailing circumstances. Whether this situation suggests fiduciary violations for failing to maintain adequate cash reserves or merely results from the unprecedented drop in real estate in the late eighties cannot be decided on this record. That issue can be taken up at trial. Prudence cannot be determined as a matter of law in this case. [FN3]

*3 The cases cited by the movants which appear to support their motion contain key factual differences from this case. In *Pratt v. Petroleum Production Mgmt. Employee Sav. Plan,* 920 F.2d 651 (10th Cir.1990), the plaintiff was terminated from his employment and became entitled to a distribution of employer securities from his Employer Contribution Account. The Account plan indicated that valuations would date back to the last day of the 'plan year.' Between the valuation date and the plaintiff's separation, the value of the securities declined markedly. The defendants wanted to avoid paying at the higher rate in order to preserve more value for the remaining participants, so they amended the plan to include interim valuation dates and applied the amendment retroactively. Here, the withdrawing participants requested redemption of their units worth 175.5 million dollars, almost a third of the entire Fund before it was substantially written down. By

satisfying those requests through the "fire sale" FBC refers to, the Trustee would have injured the withdrawing participants as well as the remaining participants--the total value of the Fund would sink, including the unit value for the withdrawing participants. Unlike the defendants in *Pratt,* the Trustee here is not preferring the remaining participants over the withdrawing participants, nor is it depriving the withdrawing participants of a predetermined value for their units. In addition, unlike the *Pratt* trustees, the Trustee in this case is not dealing with a one time depletion. It could not amend the documents to prevent further injury to the Fund as a result of the drop in the market and additional withdrawals. FNBC's Restructuring Proposal failed because of lack of unanimity; no amendment assured the Trustee that the market fluctuation would not be a source of continuing harm to the Fund.

Dardaganis v. Grace Capital Inc., 889 F.2d 1237 (2nd Cir.1989) is also distinguishable. The court specifically noted that the plan trustees in that case did not show that their compliance with the specific and unambiguous document provision would have been imprudent, or that adherence to the provision would have caused them to violate any ERISA provision. [FN4] Id. at 1242. The trustees tried to defend themselves on the basis that they had been prudent under the circumstances so no violation occurred. Those defendants seemed to argue that, even if they could have prudently followed the document provision, they could also decide to follow a different course and should only be found liable if their conduct was imprudent. *Id.* at 1240. In this case, FNBC acknowledges that, if it could have been prudent and followed the one year provision in the document, it would have been bound to do so. The Trustee has made a sufficient showing that adherence would have been imprudent, not just that it chose some equally prudent course.

To the extent that *Dardaganis* holds, rather than says, that failure to follow documents causes a per se violation under § 404(a)(1)(D) and creates liability without regard to the issue of prudence (and thereby without a possible prudence defense), this Court declines to follow the Second Circuit's rationale. All of the § 404(a) subsections should be read together; § 404(a)(1)(D) explicitly includes a need for consistency with other sections. Consistency does not make the subsections other than (B) meaningless. It simply requires a coherent rule which should be applied with enough flexibility to avoid imprudence, yet with enough certainty for confident participation in funds. In addition, the (a) subtitle, prudent man standard of care, covers all of the § 404(a) subsections.

*4 The doctrine of estoppel raised by UFCWU does not apply here. FNBC has not made a material misrepresentation. It represented that it would satisfy withdrawal requests within one year, fully intending to abide by that provision. Unlike the situation in *Black v. TIC Investment,* 900 F.2d 112 (7th Cir.1990) where the employer notified the employee that plan payments would be made when they were approved by the bankruptcy court and then deviously contested the payments, the Trustee here never made a statement knowing that it was misleading and intending it to be so. In addition, all of the representations in the documents were to be governed by ERISA, including ERISA standards of prudent conduct. Therefore, it was always implicit in the statement about withdrawals that the provision would be adhered to unless it became inconsistent with ERISA for some reason. Here, prudence is the reason.

The Trustee, by making a sufficient showing at this stage that compliance with the Trust Agreement would have violated its fiduciary duty of prudence, can withstand the summary judgment motions. It will bear the burden of proof at trial on this point. The Court is not unaware of the fact that the withdrawing participants have been injured in this case; they have lost the time value of their money, and perhaps more importantly, they have lost control over their investment. The Trustee has held their money for more than two years longer than they expected, and they have no idea when the redemption of their shares will finally occur. The Trustee will have to defend its actions and convince a trier of fact that the prudence standard required it to deviate from the plan documents in order to discharge its duties with care, skill, and prudence for the benefit of the participants. The motions for summary judgment on Standard Oil's Count II of its counterclaim and UFCWU's Count I of its counterclaim are denied. [FN5]

FN1. The facts of this case and a related case have been described in greater length and detail in previous opinions by this Court. Those opinions are *First National Bank of Chicago v. Clarke,* 90 C 5963, 1991 U.S. Dist. LEXIS 11070 (N.D.Ill. August 6, 1991) and *First National Bank of Chicago v. Retirement Trust for Employees*

of Standard Oil and Subsid., et al., 90 C 3981, 1991 U.S. Dist. LEXIS 761 (N.D.Ill. January 8, 1991).

FN2. In addition, the regulations of the Comptroller of the Currency require withdrawals from this type of fund to be paid within one year. 29 C.F.R. § 9.18(b)(4). The Comptroller declined to waive application of that regulation despite the Bank's request, and the Court has previously ruled that the Comptroller's decision is not reversible under the narrow standard of administrative review.

FN3. Contrary to the movants' argument, this Court did not previously hold either that FNBC was imprudent or that it could not assert a prudence defense to a claim of failure to pay withdrawal requests within one year as required by the trust agreement. The Court simply refused to set aside the Comptroller's denial of FNBC's request for waiver of the one year regulation, under a narrow standard of review.

FN4. On similar grounds, another case relied on by the movants can be distinguished. The court in *Clarke v. Bank of New York,* 687 F.Supp. 863 (S.D.N.Y.1988), found that no credible evidence, and in fact contradictory testimony, was presented that complying with the plan's instructions would not have been prudent. *Id.* at 868.

FN5. The request for a distribution of cash currently held by FNBC in Fund F is denied. The Court will allow FNBC to decide how to satisfy requests including with in-kind distributions, to minimize the seemingly inevitable losses, for the benefit, and in the interests, of all the participants.

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MARSHALL v. CUEVAS

U.S. District Court,
District of Puerto Rico

RAY MARSHALL v. HARRY CUEVAS, JOSE JENDI, FRANCISCO ARCHILLA, and SERGIO CARDONA, trustees of the Plan de Bienestar Sindicato Obrero Insular, No. 77-1401, March 26, 1979.

ERISA— PROTECTION OF RIGHTS

Fiduciary Responsibility — Fiduciary Duties — Exclusive Purpose (▶ 20.210)

Fiduciary Responsibility — Prohibited Transactions — Transaction Between Plan and Party In Interest (▶ 20.405)

Fiduciary Responsibility — Liability for Breach — Defenses (▶ 20.653)

Health and welfare benefit plan trustees violated ERISA Sections 404(a)(1)(A) and 406(a)(1)(D) by gratuitously transferring sum of money from assets of trust fund to widow of plan founder, notwithstanding fact that payment was alleged to have been made to reimburse legitimate expenses incurred by founder on behalf of plan and that transfer was not made for personal gain of trustees; trustees failed to provide court with authority to establish that *quantum meruit* is defense to action for ERISA violation.

Action by Labor Department to compel restoration of trust fund assets transferred in violation of ERISA Sections 404(a)(1)(A) and 406(a)(1)(D). Judgment for plaintiff.

Robert P. Gallagher, Monica Gallagher, Associate Solicitor, Carin Ann Clauss, Solicitor of Labor, Plan Benefits Security Division, U.S. Department of Labor, Washington, D.C., attorneys for plaintiff.

Nicholas Delgado Figueroa, of Delgado & Zemen, of Santurce, Puerto Rico, attorney for defendants.

Full Text of Opinion

KAESS, U.S. District Judge.

This matter coming before the Court on February 23, 1979, for a nonjury trial, and Defendants having been given until February 28, 1979, to submit a memorandum of law containing legal authority to support their defenses, and such a memorandum having been received by the Court and a responsive brief having been submitted by the Plaintiff, this Court is constrained to make the following findings of fact and conclusions of law.

On or about May 5, 1975, Defendants Harry Cuevas, Jose Jendi, Francisco Archilla, and Sergio Cardona were trustees of the Plan de Bienestar Sindicato Obrero Insular (hereinafter referred to as "the Plan"). The Plan was established by the Sindicato Obrero Insular (hereinafter referred to as "the Sindicato"), a labor union, to provide health and welfare benefits to plan participants who are members of the Sindicato.

The Plan is an employee welfare benefit plan within the meaning of Title I of the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. Sec. 1002(1), and is subject to the coverage of ERISA pursuant to 29 U.S.C. Sec. 1003(a), and is not subject to any exemption from coverage contained in 29 U.S.C. Sec. 1003(b).

The Defendants were trustees of the Plan within the meaning of 29 U.S.C. Sec. 1002(1).

On May 5, 1975, the Defendants failed to discharge their duties as required by 29 U.S.C. Sec. 1104(a)(1)(A), in that they paid or caused to be paid from the assets of the trust fund of the Plan the sum of $14,275.23 to the Housing Investment Corporation on behalf of and for the benefit of Mrs. Juan B. Emmanuelli, the widow of the founder of the Sindicato, the Plan, and a former trustee of the Plan. This transfer was made in violation of 29 U.S.C. Sec. 1106(a)(1)(D) because Mrs. Emmanuelli was a party in interest with respect to the Plan within the meaning of 29 U.S.C. Sec. 1002(14)(F).

This gratuitous transfer was made to the widow of the founder of the union and the Plan, the latter having worked very hard for a number of years at minimal salary from the union and without seeking reimbursement for his legitimate expenses incurred on behalf of the Plan. Not having provided for his family's financial security, this gift was made to the widow to save the family home. There is no question that the transfer

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Prior to making the transfer, the trustees sought legal advice and were informed that such a transfer could be made, but that the expenses which the transfer was supposed to reimburse must be detailed, and that approval for the transfer should be sought from the Department of Labor. Without complying with the recommendation of counsel, the trustees made the transfer. They did so at their own peril.

While the action taken by Defendants was morally commendable, it was a violation of the law. The defenses raised by Defendants include *quantum meruit* based on the unjust enrichment of the Plan by not reimbursing the founder for his expenses and the argument that the transfer was for the legitimate expenses incurred by the founder on behalf of the Plan. Defendants have provided this Court with no authority to indicate that *quantum meruit* is a defense to this type of action. Neither have Defendants provided any bills or vouchers to indicate that the transfer was to reimburse for expenses. Hence, this Court has no option but to find for the Plaintiff. Perhaps the liability of the Defendants can be limited by having the membership of the union take up a collection in order to reimburse the trust fund.

It is not without some sympathy that this Court finds the Defendants joint and severally liable. IT IS ORDERED AND ADJUDGED that Defendants pay to the trust fund of the Plan the sum of Fourteen Thousand Two Hundred Seventy-Five and 23/100 Dollars ($14,275.23), plus interest from May 9, 1975 until the date such amount is restored to the Plan.

GENERAL MOTORS CORP. v. TOWNSEND

U.S. District Court,
Eastern District of Michigan

GENERAL MOTORS CORP. v. WILLIE D. TOWNSEND, and THE HONORABLE JOHN W. BAKER, CIRCUIT JUDGE, CIRCUIT COURT FOR THE COUNTY OF GENESEE, STATE OF MICHIGAN, No. 6-72159, Dec. 16, 1976 [468 F.Supp. 466].

INTERNAL REVENUE CODE

Minimum Vesting Standards — Permitted Forfeitures — Assignment/Alienation of Benefits (▶ 113.204)

[1] Benefits provided by retirement program were not subject to garnishment to enforce family support obligations, since retirement program was covered by ERISA Section 206(d), which prohibits assignment or alienation of plan benefits.

ERISA— PROTECTION OF RIGHTS

Preemption — Domestic Relations Laws (▶ 50.40)

INTERNAL REVENUE CODE

Minimum Vesting Standards — Permitted Forfeitures — Assignment/Alienation of Benefits (▶ 113.204)

STATE LAWS

Regulation of Benefits — Constitutionality (▶ 281.50)

[2] Michigan law permitting assignment of and levies on pension or retirement benefits does not constitute "state law" within meaning of ERISA Section 514 preemption clause, since its relationship to employee benefit plans is too indirect to come within scope of Section 514; however, ERISA Section 206(d)'s prohibition against assignment or alienation of plan benefits supersedes contrary state law under Supremacy Clause of U.S. Constitution.

On plaintiff's motion for a temporary restraining order and permanent injunction to restrain the enforcement of a garnishment order against the General Motors Retirement Program. Motion granted.

David Davis, of General Motors Corp., of Detroit, Mich., attorney for plaintiff.

Richard Banas, of Flint, Mich., attorney for defendants.

Full Text of Opinion

GUY, District Judge.

Plaintiff commenced this action in federal court to obtain a Temporary Restraining Order and Permanent Injunc-

ith the documents covering the

onse, plaintiffs argue that the ty of a request for partition de- on a thorough review of the ircumstances of the former par- ' request and of the funds' deni- intiffs further argue that defen- ve resisted plaintiffs' efforts to iscovery, and plaintiffs have no discovery concerning their or partition. Plaintiffs also argue ir claim to partition is based on ns of the LMRA and ERISA and trust agreement may not take ights conferred by those statutes. er, plaintiffs argue that the trust nt read as a whole would not vely entitle defendant MCTWF mary judgment as it does not guously prohibit a partition of employer contributions to a wel- d that provides benefits to for- rticipants of the MCTWF.

neaning of the language of the reement itself creates a genuine material fact making disposition nmary judgment inappropriate. *icklayers' Health and Welfare und v. Brick Masons' Health and Trust Fund,* 656 F.2d 1387 [2 921] (9th Cir. 1981). However, suming, arguendo, that the lan- f the agreement precludes a pro rtition of the MCTWF's surplus, urt still must determine whether of a pro rata distribution would the LMRA or ERISA as a trust ent cannot abrogate rights which ffs enjoy under ERISA. 29 U.S.C. a)(1)(D). Mere failure to partition plus in the fund does not, stand- one, violate ERISA, *Pierce v. IBEW Welfare Trust Fund,* 488 p. 599 (E.D. Tenn. 1978), *aff'd,* 620 39 [2 EBC 2470] (6th Cir. 1980), enied, 449 U.S. 1015 (1980), nor MRA, *Local Union No. 5, Sheet Workers' International Ass'n v. ing & Trumbull County Building Welfare Fund,* 541 F.2d 636 (6th 976). Nevertheless, my examina- the authority relied on by defen- o support its proposition that nas been no violation of ERISA

nor of the LMRA leads me to conclude that where there are genuine issues of material fact regarding allegations of fraud and mismanagement, summary judgment must be denied. Those cases found no violation of the acts by changes in eligibility requirements only after a trial at which factual disputes, if any, were resolved in the defendants' favor. See *Pierce v. NECA-IBEW, supra; Local Union No. 5 v. Mahoning & Trumbull, supra* ("We are particularly unwilling to invalidate the amended rule where there is no intimation of bribery, extortion, or union misuse of funds that would strike at the purposes of section 186, ... " *Id.* at 639.). See also *Elser v. I.A.M. National Pension Fund,* 684 F.2d 648 [3 EBC 2155] (9th Cir. 1982) (District court's finding that cancellation provisions were arbitrary and capricious in case submitted on stipulated facts affirmed by circuit court where there was no actuarial evidence that provisions were necessary or reasonable to protect the financial stability of the fund.). Accord, *Central Tool Co. v. International Ass'n of Machinists National Pension Fund,* 523 F. Supp. 812 [2 EBC 2019] (D.D.C. 1981). *Cf. International Ass'n of Bridge, Structural and Ornamental Iron Workers Local 111 v. Douglas,* 646 F.2d 1211 [2 EBC 1470] (7th Cir.), *cert. denied,* 454 U.S. 866 [2 EBC 2008] (1981) (District court's conclusion as a matter of law that amendment of eligibility rule was arbitrary and capricious was reversed by circuit court because there was no evidence of any abuse of discretionary authority and the decision to adopt the amendment appeared to have been made for the sole benefit of the employees covered by the Plan).

These decisions compel this court to conclude that the determination whether the refusal to partition the MCTWF's surplus violates the LMRA or ERISA cannot be disposed of by a summary judgment as there remain genuine issues of material fact concerning the propriety of the conduct of the fund's trustees with respect to the management of the fund and the decision to deny a pro rata partition. Accordingly, defendant Michigan Conference of Teamsters Welfare Fund's motion for summary judgment is denied.

SO ORDERED.

MARSHALL v. MERCER

U.S. District Court, Northern District of Texas, Fort Worth Division

RAY MARSHALL, Secretary of the U.S. Department of Labor, v. TOMMY MERCER and WANDA JO MERCER, Civil Action No. 4-79-390-K, May 27, 1983.

ERISA — PROTECTION OF RIGHTS

Fiduciary Responsibility — Effective Dates and Transitional Rules — In General (► 20.821)

[1] Pension plan was not terminated prior to Jan. 1, 1975, effective date of ERISA where, following that date, annual reports were filed with Labor Department, forms were filed with IRS, and termination insurance premiums were paid to PBGC.

Definitions — Fiduciary (► 5.31)

[2] Wife of named trustee of pension plan was not plan fiduciary, as defined by ERISA, where she was never appointed a plan trustee, where she exercised no authority or control as to plan assets or their management, and where her actions were only by authority of her husband, for whom she was, in effect, an agent.

Fiduciary Responsibility — Statute of Limitations (► 20.80)

[3] Secretary of Labor's action against trustee of pension plan alleging various fiduciary violations, was not barred by statutes of limitations, since three-year limit does not apply where secretary did not have either actual or constructive knowledge of breach and Secretary's action was filed within six-year limit.

Fiduciary Responsibility — Effective Dates and Transitional Rules — In General (► 20.821)

[4] Transitional exemptions of ERISA Section 414 do not apply to loans be-

tween pension plan and plan sponsor and other related business entities, where interest payments called for by loans were not made, since loans thus did not remain at least as favorable to plan as arm's length transaction with unrelated party would have been.

Fiduciary Responsibility — Fiduciary Duties — Exclusive Purpose (► 20.210)

Fiduciary Responsibility — Fiduciary Duties — Prudence Standard (► 20.225)

Fiduciary Responsibility — Fiduciary Duties — Diversification of Investments (► 20.245)

[5] Pension plan trustee violated his fiduciary duties under ERISA Sections 404(a)(1)(A), (B), and (C), where he refrained from attempting to collect on certain obligations owing to plan because he feared such action would force various business entities into bankruptcy, where he used plan's funds as alternate source of credit for his companies when said companies appeared to be faltering, where there is no evidence he asked for more security, required personal guarantees, or took other action normal creditor would take to secure repayment, and where 85 to 90 percent of plan assets were concentrated in loans to entities.

Fiduciary Responsibility — Prohibited Transactions — In General (► 20.401)

[6] Various loan transactions, extensions of credit, and transfers of plan assets from pension plan to various business entities controlled by plan trustees violated ERISA Section 406, since they constituted extensions of credit to parties in interest, since plan trustee was acting on behalf of his own interest, and since plan trustee was acting on both sides of transaction.

In Secretary of Labor's action against the defendants alleging breaches of ERISA fiduciary responsibility provisions. Judgment as per opinion.

James Petrick and Andrea Selvaggio, Plan Benefits Security Division, Office of the Solicitor, U.S. Department of Labor, Washington, D.C., attorneys for Secretary of Labor.

Mack Ed Swindle, of Gandy, Michner, Swindle, Whitaker, Pratt & Mercer, of Fort Worth, Tex., attorney for Mercers.

Full Text of Opinion

BELEW, District Judge.

This is an action brought by the Secretary of the Department of Labor, hereinafter referred to as "the Secretary," under Title I of the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. §1001, *et seq.* In his complaint, the Secretary alleged breaches of the fiduciary responsibility provisions of ERISA and prayed for the broad equitable relief specifically made available under ERISA, including removal of Defendants as fiduciaries of the Plan, and restoration to the Plan, out of the personal assets of Defendants, of the money it had lost as a result of Defendants' breaches.

Trial was held before the Court. Having reviewed the evidence and legal arguments presented, the Court makes the following findings of fact and conclusions of law.

FACTS

The facts are as follows. The T. E. Mercer Employees' Retirement Plan was established on December 31, 1955, by the T. E. Mercer Trucking Co. ("the Trucking Co.") to provide retirement income to employees covered by such plan. The Employee Retirement Income Security Act of 1974 went into effect on January 1, 1975. While the Defendants contend that the Plan was terminated on or before January 1, 1975, the Plan was never formally terminated according to the provisions of Article XIV of the Plan document.

According to the original plan documents, the initial trustees of the Plan were Defendant Tommy Mercer, his grandmother, Mrs. T. E. Mercer, and T. T. Trevett. As of November 11, 1970, the trustees were Tommy Mercer, his mother, Mrs. George E. Mercer, and his sister, Jolene Mercer Nunn. Mrs.

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George Mercer died in 1972 and Jolene Mercer Nunn resigned as trustee in 1973. The record does not reflect who, if any, the successor trustees were.

At one time the Mercer family, through numerous companies, was involved in a large number of different business ventures. These companies included corporations, partnerships and sole proprietorships. Four companies are particularly relevant to this case because of their financial entanglement with respect to each other and with respect to the Plan. These companies are:

(1) The T. E. Mercer Trucking Company which sponsored the Plan was, as of 1975, wholly owned by Tommy Mercer.

(2) G.E.M. Storage and Terminal Co. ("G.E.M.") was a corporation which was originally owned by several members of Tommy Mercer's family, but by 1975 Tommy Mercer became the sole shareholder. Originally, G.E.M. did some business as a stevedoring company, but by 1975 its main function was to hold land and lease it to the Trucking Co.

(3) Maverick Equipment Co. ("Maverick"), another Mercer entity, merged with G.E.M. in 1972, and as a result of this merger, G.E.M. acquired a large debt which Maverick had owed the Plan.

(4) Heritage Investments was, as of 1975, a sole proprietorship owned by Tommy Mercer.

The Defendants, on behalf of the Plan, made a series of loans to Mercer-controlled companies that have never been repaid, leaving the Plan with few assets. These loans are the core of this controversy.

A. *Loans from the Plan to G.E.M.*

The alleged Defendant-trustees, acting for the Plan, made two loans to G.E.M., which were evidenced by notes. These loans have not been repaid.

The larger of these notes, in the principal amount of $241,366.26, was dated January 1, 1974. It provides for interest at six percent (6%) per annum, and was issued under the signature of Defendant Tommy Mercer, signing as president of G.E.M. This note has no due date, but rather is characterized as being due "on demand, plus one year."

G.E.M.'s other obligation to the Plan was evidenced by a note for $43,563.60, at eight percent (8%) interest, dated February 26, 1970, also under the signature of Tommy Mercer. The terms of this note are stated as "interest payable annually on December 31, of each year as it accrues, both principal and interest payable one year after demand." The note specifically states that upon default in the punctual payment of any part thereof, principal or interest, the whole amount will be matured at the option of the holder.

As of January 1, 1975, $87,413.08 of interest was overdue on these two notes. The Plan trustees never collected on the G.E.M. notes even though they could have been called at any time.

The larger note in the principal amount of $241,366.26 was secured by a security agreement dated January 1, 1967. The collateral listed in said agreement consisted of automotive equipment, an airplane, and a lifting crane.

The other G.E.M. note for $43,563.60 states that it is secured by property: Lots 1-7 and 16-24 inclusive, all in Block 43, North Fort Worth Addition to the City of Fort Worth. Attached to the note was a deed of trust for this property.

B. *Loans from the Plan to Heritage Investments.*

Tommy Mercer further authorized the Plan to make certain loans to a Mercer-owned entity known as Heritage Investments. These were, in effect, loans to Tommy Mercer personally since Heritage Investments was a sole proprietorship.

The larger of these loans to Heritage was in the principal amount of $34,000 at six percent (6%) interest, evidenced by a note dated July 1, 1974, signed by Tommy Mercer, and secured by a piece of property in Block 44 of the North Fort Worth Division of the City of Fort Worth. The Plan also held a second note issued by Heritage Investments, dated January 1, 1969, for $5,786.71 at seven and one-fourth percent (7-¼%) interest. This smaller note was unsecured.

No interest was ever paid on these notes although, like the G.E.M. notes, interest was payable annually. As of

January 1, 1975, $15,507.08 of interest was due on the two notes. The property securing the larger note was sold by Wanda Jo Mercer, "as trustee of the Plan," in August, 1979. (It is not entirely clear how the Plan came to own this property since no official documents evidencing the foreclosure were filed in the appropriate Tarrant County offices.)

The amount the Plan received, $58,472.36, substantially satisfied both debts, including interest.

C. *Transfers of assets from the Plan to the Trucking Co.*

On December 31, 1974, the Board of Directors of the Trucking Co. voted to make a $25,000 contribution to the Plan. This amount was duly recorded in the Plan's accounts as a "contribution receivable." The Trucking Co. never actually made this contribution although the amount of the receivable was reduced by amounts the Trucking Co. paid directly to certain participants as benefits due them from the Plan.

Just prior to the Trucking Co.'s bankruptcy, a series of transfers were made to the Trucking Co. from the Plan's bank accounts at the direction of Tommy Mercer. No cash remained in the Plan after these transfers. These transfers plus the remaining part of the contribution receivable owed by the Trucking Co. resulted in a net gain to the Trucking Co. of $35,639.88. Further, said monies were used to pay operating expenses of the Trucking Co. The Plan was never given a note for these amounts, nor were these amounts secured in any way.

At the time this suit was instituted, both T. E. Mercer Trucking Co. and G.E.M. Storage were in bankruptcy.

ISSUES

At issue in this case are the following:

1. Had the Plan been terminated prior to the effective date of ERISA?

2. Was Wanda Jo Mercer a trustee of the Plan?

3. Is this action barred by the Statute of Limitations of ERISA §413, 29 U.S.C. §1113?

4. Do the transitional exemptions of ERISA §414, 29 U.S.C. §1114, apply to the transactions involved herein?

5. Did the trustee(s) of the Plan violate either §404 or §406 of ERISA, 29 U.S.C. §§1104, 1106?

Each will be addressed below.

1. *HAD THE PLAN BEEN TERMINATED PRIOR TO THE EFFECTIVE DATE OF ERISA?*

It is clear that the Plan, here in question, would be covered under ERISA if said Plan was still in effect after January 1, 1975. Title 29, United States Code, Section 1002(2), defines "employee pension benefit plan" as "any plan ... established or maintained by an employer ... to the extent ... such plan (A) provides retirement income to employees." This Plan was established by an employer, the T. E. Mercer Trucking Co. and by its express terms it provides retirement income to employees.

[1] Defendants contend, however, that the Plan was terminated prior to January 1, 1975, the effective date of ERISA. In support thereof, Defendants assert that all transactions relative to the Plan had ceased prior to 1975 and that the trustee(s) was merely engaged in winding up the Plan (e.g.) collecting debts, and paying benefits which had been voted and designated in 1974. The Court, however, is convinced that said Plan was not terminated prior to 1975.

In the first place, Defendant(s), as administrator of the Plan, filed reports with the Department of Labor pursuant to the requirements of ERISA. With the inception of ERISA, apparently there was confusion as to the filing requirements of said Act. However, in a report filed by the Defendants, dated December 17, 1976, the question was asked whether the Plan had been terminated. Said report responded in the negative.

Annual reports were filed for the Plan through 1977. In the 1975 annual report, Edwin Neville, President of Neville & Co., the Plan's pension consultant, attached his letter to said report stating that "T. E. Mercer and Wanda Jo Mercer *continue to serve* as trustees." There was no indication in any of the

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annual reports that said Plan had been terminated. Further, neither Margaret Breen nor Doris Burleson, the Trucking Co. employees who kept the Plan's books and records, was ever informed or believed that the Plan was terminated. In addition, the Trucking Co. employees — those most directly affected — were never told that the Plan had been terminated prior to 1975.

Apparently the employees were told in 1977 that the Plan was being amended because in June, 1977, the Board of Directors of the Trucking Co. passed a resolution to amend the Plan, effective January 1, 1976. The amendments, which were signed by both Defendants as trustees, separated the Plan into two plans, a profit sharing plan and a past service pension plan. These amendments were then filed with the Internal Revenue Service (IRS) along with the appropriate forms. These forms, signed by Tommy Mercer, specifically requested tax-qualified status for an *amended* plan.

Included with the Plan amendments was a "Notice to Active and Retired Employees," explaining the amendments to the employees. The forms filed with the IRS in connection with these amendments also state that the employees had been notified of the amendments in June 1977 by written summary. In November of 1977, just prior to the Trucking Co.'s filing of bankruptcy, said application to amend the Plan was withdrawn.

Moreover, for the Plan years 1974-1977, the Defendants filed "Premium Payment Declarations," and paid plan termination insurance premiums to the Pension Benefit Guaranty Corporation (PBGC). This corporation was set up by Congress to provide insurance protection for participants of active and defined benefit plans whose plans might, in the future, terminate without sufficient funds to pay their benefits. There would be no need for a terminated plan to pay such premiums.

Finally, the Plan was never formally terminated according to the provisions of the Plan document itself, nor have the Defendants claimed that the Plan was so terminated.

The evidence introduced at trial strongly supports Plaintiff's contention that the Plan has never been terminated. While the Defendants claim that in their capacity of trustees, they were in the process of winding up the Plan, the actions of the trustees and all those associated with the Plan were inconsistent with this assertion.

2. *WAS WANDA JO MERCER A TRUSTEE OF THE PLAN?*

It is clear that Defendant Tommy Mercer was a plan "fiduciary" as defined in ERISA. A "fiduciary" is defined in ERISA §3(21), 29 U.S.C. §1002(21) as follows:

> A person is a fiduciary with respect to a plan to the extent (i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets . . . or (iii) he has any discretionary responsibility in the administration of the plan.

Tommy Mercer was a *named* trustee of the Plan from December 31, 1955 to December 18, 1979. On that basis alone, he was a fiduciary to the Plan because he had "discretionary responsibility in the administration of the plan" by virtue of that position. *Freund v. Marshall and Ilsley Bank*, 485 F. Supp. 629, 635 [1 EBC 1898] (W.D. Wis. 1979). Tommy Mercer also admitted that he, in fact, exercised "some authority and control respecting management and disposition of the assets of the Plan."

The Defendants, however, contend that Wanda Jo Mercer was neither a trustee nor a fiduciary of the Plan. No written evidence has been produced which would show that Wanda Jo Mercer was actually appointed by the Board of Directors as trustee of the Plan. However, a letter from Margaret Breen, dated August 30, 1972, informed the Plan's pension consultants that Wanda Jo Mercer had replaced Mrs. Helen Mercer (Tommy Mercer's mother) as trustee. Margaret Breen also testified that she would not have written such a

letter unless instructed to do so by Tommy Mercer. Various documents signed by Tommy Mercer refer to Wanda Jo Mercer as a trustee. These include the EBS-1 form filed with the Department of Labor, and the minutes of a 1977 meeting of the Board of Directors, in which the Plan amendments were adopted.

There was also evidence that Wanda Jo Mercer acted as a Plan trustee. Her signature appears on the Plan amendments dated June 9, 1977; on the forms filed with the PBGC; and, most significantly, on a deed conveying property which had secured one of the Plan's loans to a Mercer-Controlled entity. Further, Mrs. Mercer testified at trial that she had, in fact, signed these documents.

[2] Despite the above, the Court finds that Wanda Jo Mercer was not a trustee of the Plan. She was never appointed as such by the Board of Directors and never exercised the managerial and administrative powers that a trustee possesses. Any designation of Mrs. Mercer as a trustee was merely the result of a misunderstanding between Mrs. Breen and Tommy Mercer, which gave rise to Mrs. Breen's above mentioned letter to Mr. Neville. Mr. Neville, in reliance upon said letter, prepared various instruments and documents which included Mrs. Mercer's name as "trustee," and directed Mrs. Mercer to sign, which she did.

It should be pointed out that whether Mrs. Mercer was given the title of "trustee" is not dispositive. What is crucial under ERISA is what powers and authority Mrs. Mercer actually possessed. The real issue is whether she "(1) ... exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of the assets ... or (iii) [s]he has any discretionary responsibility in the administration of the plan." 29 U.S.C. §1002(21).

The evidence introduced at trial clearly showed that Mrs. Mercer had no discretionary authority or control respecting any facet of the plan. Wanda Jo Mercer merely signed what she was told to sign. Further, Tommy Mercer testified on cross-examination that he approved all decisions relating to the plan and could have vetoed any course of action recommended by Mr. Neville or anyone else.

With regard to whether Mrs. Mercer's signing of a closing statement and a deed to certain property constituted the exercise of "any authority or control respecting management or disposition of (the plan's) assets," the Court is of the opinion that it did not.

It is the opinion of the Court that Wanda Jo Mercer signed the settlement agreement and deed as an agent for her husband Tommy Mercer. The property in question secured two loans made by the Plan to Heritage Investments. After the Trucking Co. and G.E.M. filed bankruptcy, Mr. Mercer found a purchaser (Texas Refinery) for said property. While out of State on business, problems arose and the deal was almost lost. Mr. Mercer then contacted Mr. Pate of Texas Refinery in order to preserve the sale. It was understood that the proceeds from the sale of this property would be paid to the Plan to pay the two notes representing loans to Heritage Investments. At the direction of Meto Metiff (the attorney representing the Plan at the closing) Mrs. Mercer signed the deed and closing agreement in place of Tommy Mercer. The testimony showed that there was concern whether the sale would be consummated. In order to secure the sale of the property, the signing of the papers had to be expedited. Thus, Mrs. Mercer signed for her husband.

The evidence at trial clearly demonstrated that Wanda Jo Mercer exercised no authority or control with respect to the assets of the Plan or their management. It is apparent that Mrs. Mercer acted only by the authority of her husband, and was in effect an agent for Tommy Mercer. Accordingly, Wanda Jo Mercer was not a fiduciary of the Plan, as defined by ERISA §3(21), 29 U.S.C. §1002(21).

3. *IS THIS ACTION BARRED BY THE STATUTE OF LIMITATIONS OF ERISA §413, 29 U.S.C. §1113?*

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Defendants affirmatively allege that this action is barred by the Statute of Limitations as contained in ERISA §413, 29 U.S.C. §1113. Section 413 of the Act provides in pertinent part as follows:

> (a) No action may be commenced under this subchapter with respect to a fiduciary's breach of any responsibility, duty, or obligation under this part, or with respect to a violation of this part, after the earlier of—
>
> (1) six years after (A) the date of the last action which constituted a part of the breach or violation, or (B) in the case of an omission, the latest date on which the fiduciary could have cured the breach or violation, or
>
> (2) three years after the earliest date (A) on which the plaintiff had actual knowledge of the breach or violation, or (B) on which a report from which he could reasonably be expected to have obtained knowledge of such breach or violation was filed with the Secretary under this subchapter.

ERISA does not apply retroactively. See *Martin v. Bankers Trust Co.*, 565 F.2d 1276 [1 EBC 1793] (4th Cir. 1977). Thus, the Statute of Limitations, 29 U.S.C. §1113, cannot begin to run until the effective date of the Act, or January 1, 1975. Further, a cause of action accrues at the first instance when a party can legally maintain such action. *Great American Insurance Co. v. Louis Lesser Enterprises, Inc.*, 353 F.2d 997, 1001 (8th Cir. 1965); *Keller v. Graphic Systems of Akron, Inc., Etc.*, 422 F. Supp. 1005, 1008 (N.D. Ohio 1976). Plaintiff has alleged that Defendants breached their fiduciary responsibilities by failing, after 1975, to collect on loans made in 1969 and 1970 and, in one case, renewed in 1974. Therefore, regarding the alleged violations filed herein, the effective date is January 1, 1975. Accordingly, Plaintiff's suit, filed on November 5, 1979, was well within the six-year Statute of Limitations of ERISA §413(a)(1).

Defendants further assert that this action is barred by the three-year Statute of Limitations, 29 U.S.C. §1113(a)(2) (set out above). Essentially, Defendants argue that the filing of certain forms with the Internal Revenue Service for tax years prior to the effective date of ERISA, and pursuant to a separate statute (the Internal Revenue Code of 1954, as amended, (the code), 26 U.S.C. §1 *et seq.*), triggered the running of the three-year Statute of Limitations provided for in ERISA. The language of subparagraph (2) clearly anticipates two separate types of knowledge which can trigger the three-year period of limitations: actual knowledge of a violation, §413(a)(2)(A); or "constructive" knowledge gained through reports filed with the Secretary of Labor, §413(a)(2)(B).

An explanation of the federal law which regulated employee benefit plans prior to ERISA is helpful. As summarized in the Plaintiff's post-trial brief: "Prior to the passage of ERISA, the Code required an annual return be filed with the Internal Revenue Service (IRS) by tax-exempt employee trusts such as the T. E. Mercer Employees' Retirement Plan (the Plan). This tax return was entitled "Return of Employees' Trust Exempt from Tax" or "990-P." The form was an informational return which contained data verifying the tax exempt status of the employee benefit trust.

Another form, called an "Employee Welfare and Pension Plan Annual Report" or "D-2," was required to be filed with the Department of Labor (DOL) under the Welfare and Pension Plans Disclosure Act (WPPDA), 29 U.S.C. §301 *et seq.* The D-2 served an entirely different purpose from the 990-P. Under the WPPDA, there was no cause of action for breach of fiduciary responsibility. This Act merely required reporting of general financial information to the Secretary of Labor, who then made the information available to the public. The intent of the WPPDA was to discourage abusive practices by those who controlled employee benefit plans by exposing the plan's financial dealings to public scrutiny. The WPPDA was repealed by ERISA, §111, 29 U.S.C. §1031.

Thus, although both the IRS and DOL gathered information on employee benefit plans prior to ERISA, their statutorily mandated purposes for gathering this

information were different, and their efforts were not coordinated. It was not until ERISA was passed, with its mandate for coordination and communication between the two agencies, *see generally*, §§3001-3004 of Title III of ERISA, 29 U.S.C. §§1201-1204, that information began to be shared on a regular basis.

Beginning with the first tax year after ERISA became effective, employee benefit plans such as the one involved in this case, were no longer required to file two separate forms with the IRS and the DOL. The old forms, the IRS's "990-P" and the DOL's "D-2" became obsolete. A new form, reflecting the changes in federal pension law enacted by ERISA, was created. This form, called the Annual Return/Report of Employee Benefit Plan or Form 5500, was designed to satisfy the annual reporting requirements of the IRS, the DOL, and the Pension Benefit Guaranty Corporation (PBGC), the three federal agencies charged with the enforcement of ERISA.

[3] Given this background, it is clear that the three-year Statute of Limitations does not apply to this cause. Defendants contend that due to the 990-P forms filed for the tax years 1973 and 1974, the Plaintiff had either actual or constructive knowledge of the alleged violations at that time. This is not so. First, the 990-P forms were neither filed with the Secretary of Labor nor were they filed under Title I of ERISA, 29 U.S.C. §§1001-1144 (ERISA had not yet become effective). Further, it should be remembered that the bar of the Statute of Limitations is an affirmative defense. As such, the Defendants were required to prove every element of the defense. *Fruit and Vegetable Packers and Warehousemen, Local 760 v. Morley*, 378 F.2d 738, 746 (9th Cir. 1967). There is nothing of record to indicate that the 990-P forms were in fact filed with the DOL, or that there was any sharing of information prior to January 1, 1975 between the IRS and the DOL. Further, Title 29 U.S.C., Section 1204 (of ERISA) mandates coordination of enforcement activities between the IRS and DOL. However, there is no indication in the Act or its legislative history to suggest that this provision imposed upon the Secretary a duty to search out old records of another government agency in search of violations of an act which was not in effect when the information reported on these forms was compiled.

Likewise, Defendants failed to show that any D-2 forms had in fact been filed with the DOL. Had such forms been filed with the DOL, it should be noted that the loans at issue to G.E.M. Storage and Heritage Investments would not have been reported in the Form D-2 as "party in interest" transactions. Under the WPPDA, the definition of "party in interest," 29 U.S.C. §302 (repealed by ERISA, 29 U.S.C. §103), did not include companies owned or controlled by parties in interest.

It should also be pointed out that certain post-1975 filings failed to raise a bar under the Statute of Limitations. The Plan's 1975 Annual Report, Form 5500, was not filed until December 17, 1976. Accordingly, this suit, filed November 5, 1979, was clearly instituted within three years of this date. A report filed in May, 1976, the Form EBS-1, Plan Description, also would not have provided the Secretary with knowledge of Defendants' breaches since it does not contain any information about the loan transactions which are the subject of this case.

Due to the above, as well as to the fact that Defendants wholly failed to produce any evidence suggesting that the Plaintiff had any actual knowledge of the alleged violations, it is clear that this cause was timely filed pursuant to 29 U.S.C. §1113.

4. *DO THE TRANSITIONAL EXEMPTIONS OF 'ERISA' §414, 29 U.S.C. §1114, APPLY TO THE TRANSACTIONS INVOLVED HEREIN?*

The Mercers contend that the transactions here involved are exempt from the application of ERISA until June 30, 1984, pursuant to ERISA §414, 29 U.S.C. §1114. Section 414 provides in pertinent part:

> (c) Section 1106 and 1107(a) (relating to prohibited transactions) shall not apply—

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(1) until June 30, 1984, to a loan of money or other extension of credit between a plan and a party in interest under a binding contract in effect on July 1, 1974 (or pursuant to renewals of such a contract), if such loan or other extension of credit remains at least as favorable to the plan as an arm's-length transaction with an unrelated party would be, and if the execution of the contract, the making of the loan or the extension of credit was not, at the time of such execution, making of the loan or the extension of credit was not, at the time of such execution, making, or extension, a prohibited transaction (within the meaning of section 503(b) of Title 26 or the corresponding provisions of prior law).

It should be noted that even if this exemption applied to the present case, it would not protect Defendants from liability for breaches of their duty to act prudently and solely in the interest of the participants, and beneficiaries, nor would it excuse them from their duty to diversify plan assets. As the court said in *Freund v. Marshall and Ilsley Bank, supra,* citing the legislative history of the Act, "exemptions from the prohibited transaction provisions have no effect with respect to the basic fiduciary responsibility rules of §404(a)(1). Conference Report, [H.Rep.No. 93-1280, 93 Cong., 2d Sess.] at 310, 311."

Assuming, arguendo, that the transactions here involved were not prohibited transactions under 26 U.S.C. §503(b), the Court is convinced that 29 U.S.C. §1114(c)(1) is inapplicable to said transactions for the following reasons.

[4] First, the alleged transfer of $35,639.88 from the Plan to the Trucking Co. occurred after July 1, 1974. Thus, by the express wording of the statute, Section 1114(c)(1) would not be applicable to said transfer.

Additionally, all of the loans made prior to July 1, 1974, were in default as of the effective date of the Act, January 1, 1975, due to the failure to pay interest as it came due. Surely, it cannot be said that the loans remained at least as favorable to the Plan as an arm's-length transaction with an unrelated party would be. Defendants assert that said notes contained favorable rates of interest. This is of little significance if said interest is never collected. Further, Defendants were aware of the aggressive collecting efforts being exerted by Fruehauf (a creditor of the Mercer companies). As a trustee, Tommy Mercer should have known of the difficulties that a creditor such as Fruehauf could create in collecting on said notes. In *Freund v. Marshall and Ilsley Bank, supra,* a case factually similar to the one at present, the court held that certain pre-ERISA loans were not exempt under §1114(c)(1). In so doing, the court noted that the fiduciaries had the option of terminating or modifying the existing loans to obtain better terms for the Plan.

In *Marshall v. Kelly,* 465 F. Supp. 341 [1 EBC 1850] (W.D. Okla. 1978), the court likewise held that certain loans were not exempt under §1114(c)(1). In so holding the court found that the financial condition of the company which had borrowed the money had taken a severe downturn since the loan had been made. Further, despite this downturn, the fiduciary had done nothing to bolster the Plan's position as a creditor.

In the instant case, the Mercer entities owed over five million dollars to the Fruehauf Corporation. As of January 1, 1975, Tommy Mercer, better than anyone else, knew how much trouble the companies were having repaying this loan. Despite this knowledge, Defendants did nothing to better the terms of the Plan's loans. This was so even though all of the loans made prior to July 1, 1974 were in default. Further, Fruehauf, who was unquestionably an arm's-length creditor, was able to obtain from the Mercer entities a more favorable rate of interest (3% above the prime rate). Therefore, it cannot be said that the loans "remain[ed] at least as favorable to the Plan as an arm's-length transaction with an unrelated party would be," as required by §414(c)(1).

5. *DID THE TRUSTEE(S) OF THE PLAN VIOLATE EITHER §404 OR*

§406 OF ERISA, 29 U.S.C. §§1104, 1106?

The standards regulating fiduciary conduct are set forth in Part 4 of Title I of ERISA. These standards include sections 404 and 406, 29 U.S.C. §§1104 and 1106.

Under §404(a)(1)(A)-(C), 29 U.S.C. §1104(a)(1)(A)-(C), fiduciaries are required to discharge their duties:

> ... solely in the interest of the participants and beneficiaries and —
>
> (A) for the exclusive purpose of:
>
> (i) providing benefits to participants and their beneficiaries; and
>
> (ii) defraying reasonable expenses of administering the plan;
>
> (B) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;
>
> (C) by diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so ...

The statutory phrase "solely in the interest" is at least in part a codification of the most fundamental duty traditionally owed by a trustee — the duty of loyalty. Trust law has held fiduciaries to a very high standard of conduct whenever the interests of the fiduciaries or others come into conflict with the interests of beneficiaries. *Marshall v. Kelly, supra.* Moreover, the fiduciary must bear the burden of justifying his conduct. *Marshall v. Snyder,* 572 F.2d 894, 900 [1 EBC 1573] (2nd Cir. 1978).

Significantly, the framers of section 404(a)(1)(B) established a standard of conduct based on a measure of how a prudent man in a *like capacity* and *familiar with such matters* would act. Thus, ERISA's prudence test must be applied with reference to a prudent fiduciary with experience dealing with a similar enterprise, an extremely high standard of conduct. *Marshall v. Snyder, supra; Marshall v. Kelly, supra.*

ERISA section 406, 29 U.S.C. §1106, supplements section 404 and specifically limits a trustee's exercise of discretion by expressly "prohibiting" certain enumerated types of transactions involving plan assets. In §3(14) of ERISA, 29 U.S.C. §1002(14), Congress identified certain persons ("parties in interest") who, because of their relationship to the plan or its sponsors, *may* be in a position to cause the plan to become involved in transactions which are not in the best interests of plan participants and beneficiaries.

ERISA §3(14) defines party in interest, in relevant part:

> (14) The term "party in interest" means, as to an employee benefit plan —
>
> (A) any fidiciary (including, but not limited to any administrator, officer, trustee, or custodian), counsel, or employee of such employee benefit plan ...
>
> (C) an employer any of whose employees are covered by such plan ...
>
> (G) a corporation, partnership, or trust or estate of which (or in which) 50 percent or more of —
>
> (i) the combined voting power of all classes of stock entitled to vote or the total value of shares of all classes of stock of such corporation,
>
> (ii) the capital interest or profits interest of such partnership, or
>
> (iii) the beneficial interest of such trust or estate, is owned directly or indirectly, or held by persons described in subparagraph (A), (B), (C), (D) or (E) ...

To prevent the possibilities of abuse of plan assets by such parties, Congress prohibited those transactions as *per se* violations of the Act. Under §406(a), plans are prohibited from engaging in transactions with such "parties in interest," as defined in §3(14), regardless of the prudence of the transactions. *Marshall v. Kelly, supra,* 465 F. Supp. at 354. Thus, section 406(a) makes it a violation for a fiduciary to:

> ... cause the plan to engage in a transaction, if he knows or should

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(B) lending of money or
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a party in interest; [or]
(D) transfer to, or use b
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(B) lending of money or other extension of credit between the plan and a party in interest; [or]

(D) transfer to, or use by or for the benefit of, a party in interest, of any assets of the plan ...

It is significant to note that this section imposes liability where the fiduciary "should have known" that a transaction involved a party in interest, even if he had no actual knowledge that such a transaction occurred. *Marshall v. Kelly, supra,* 465 F. Supp. at 351; *Freund v. Marshall, supra.* In cases where, as here, a fiduciary is intimately involved with the operations of the party in interest, he will be presumed to have knowledge of the prohibited transactions. *Marshall v. Carroll,* C.A. No. C-79-1495-WHO, 289 BNA Pension Reporter D-7, D-11 [2 EBC 2491] (N.D. Cal., April 18, 1980).

The prohibitions of §406(a) are supplemented by those of §406(b), 29 U.S.C. §1106(b), which provides:

A fiduciary with respect to a plan shall not —

(1) deal with the assets of the plan in his own interest or for his own account,

(2) in his individual or in any other capacity act in any transaction involving the plan on behalf of a party (or represent a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries, or

(3) receive any consideration for his own personal account from any party dealing with such plan in connection with a transaction involving the assets of the plan.

Section 406(b) thus prohibits a fiduciary from acting in any situation in which he has a personal interest which *may* conflict with the interest of the plan for which he acts. *Freund v. Marshall, supra,* 485 F. Supp. at 637.

In determining whether Mr. Mercer violated the above-mentioned fiduciary duties, the Court will examine only those circumstances which arose subsequent to the effective date of ERISA, as only these circumstances can give rise to an action for breaches of the fiduciary duties contained within ERISA. Sections 404 and 406 of ERISA, 29 U.S.C. §§1104 and 1106, will be discussed separately.

(a) *ERISA §404, 29 U.S.C. §1104.*

Under ERISA §404(a)(1)(A), it is fundamental that in all dealings with the plan assets, the fiduciary must act solely in the interest of the beneficiaries and participants of the plan. Clearly, Mr. Mercer failed to carry out this obligation.

[5] At trial, Tommy Mercer testified that he refrained from attempting to collect on certain obligations owing the Plan (by various Mercer entities) because he feared such action would force the Mercer entities into bankruptcy. Evidence of Tommy Mercer's motivations was the apparent fact that he used the Plan's funds as an alternate source of credit for his companies when said companies appeared to be faltering. Virtually all of the Plan's assets were tied up in loans to said companies. A stronger indication that Tommy Mercer failed to act solely in the interest of the Plan was a series of transactions made at Tommy Mercer's direction. Just prior to the Trucking Co.'s filing for bankruptcy, all the remaining cash of the Plan was transferred to the Trucking Co. in an apparent effort to stave off the bankruptcy. No notes or security were given for these funds. Moreover, by transferring Plan assets to the Truck Co., without security, without interest, and without any promise of repayment, Tommy Mercer also failed to exercise his duties with the prudence required by ERISA §404(a)(1)(B), 29 U.S.C. §1104(a)(1)(B). One of the fundamental duties of of a trustee is to preserve the trust's property (Bogert, *Trusts and Trustees* §582, 2nd Ed. 1960). It is, of course, obvious that the "giving away" of trust assets is imprudent and not in the best interests of the participants and beneficiaries. *Marshall v. Cuevas,* C.A. No. 77-1401, 238 BNA Pension Reporter D-6. [1 EBC 1580] (D. P.R., March 26, 1979). Clearly a prudent man in a like

capacity and familiar with such matters would not have made such transfers.

Tommy Mercer caused to be issued two loans in favor of the Plan from G.E.M. The larger of the two, with a principal amount of $241,366.26 plus interest, was secured by various automotive equipment, a crane and an airplane. The testimony and evidence at trial demonstrated that said security was inadequate. Most of the automotive equipment had been sold before 1974, the date of the note; security in the crane had apparently not been perfected; and while the proceeds from the plane had been credited to the Plan, they were withdrawn from the Plan and transferred to the Trucking Co. According to a proof of claim filed on behalf of the Plan in the G.E.M. bankruptcy case, in October, 1978, said claim was listed as unsecured.

The second note from G.E.M. was secured by certain property: Lots 1-7 and 16-24 inclusive, all in Block 43, North Fort Worth Addition to the City of Fort Worth. Testimony at trial, however, indicated that this property could be difficult for the Plan to sell because its real value would only have been realized were it sold as part of a larger tract, which was not security for the note. Thus, it is questionable whether this loan was properly secured. Moreover, this loan was in default due to the failure of G.E.M. to make various required interest payments. Despite the inadequacy of security for these notes and their continuing default status, Defendants never demanded repayment. Nor did they institute foreclosure proceedings with regard to the security they did have, or take any other action to try to collect on either the notes or on the overdue interest.

The law is clear that Tommy Mercer had a fiduciary duty after January 1, 1975, to take vigorous action to protect the Plan's interests with respect to the above mentioned obligations. In *Marshall v. Kelly, supra,* the court found that, where a fiduciary caused a plan to make pre-ERISA loans to a company in declining financial condition, with security of declining value, and failed to take any steps post-ERISA to secure repayment of the loans, he violated ERISA sections 404(a)(1)(A) and (B). In *Freund v. Marshall, supra,* 485 F. Supp. at 636, the court in considering the prudence of large loans to parties in interest made in exchange for unsecured demand notes states:

> In causing or permitting virtually all of the assets to be loaned back to the sponsoring companies in exchange for unsecured promissory notes the defendants DeKeyser, Ashley Slomann, Rooney, William Hyland, Bauer, Coggins, Daly, and Stenberg (hereafter "the old trustees") failed to discharge their duties with respect to the Plan solely in the interests of the Plan's participants and beneficiaries and for the exclusive purpose of providing benefits to participants and beneficiaries and defraying reasonable Plan administration expenses as required by section 404(a)(1)(A) of ERISA. The complete lack of security on the notes presented significant risks for the Plan which later became realities, and the interest rates paid on the notes, while generally considered high by both the trustees and Plan participants, did not adequately compensate for the risks involved. Significantly, an arm's length lender making loans to one of the same companies for the same purpose as the Plan obtained both a higher interest rate and additional security, in the form of valuable personal guarantees, neither of which advantages were obtained by the Plan. Under these circumstances, the old trustees violated their duty of prudence imposed by section 404(a)(1)(B).

As in *Kelly* and *Freund,* Tommy Mercer took no effective steps to secure repayment of the notes. There is no evidence that he asked for more security, required personal guarantees, or took any other actions available to a normal creditor to secure repayment of the debt. Accordingly, the Court must conclude that with respect to the above mentioned obligation, Tommy Mercer violated his duties as set forth in ERISA

§404(a)(1)(A) and (B), 2
§1104(A)(1)(A) and (B).

ERISA §404(a)(1)(C), 2
§1104(A)(1)(C), further requir
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the plan so as to minimize t
large losses. The key princi
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prevent plan assets from beir
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Port No. 93-1280, 93d Cong
(1974) at 304; *Marshall v.
Local 282, supra,* 458 F. Supp

Based upon the evidence c
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§1104(a)(1)(C).

(5) *ERISA §406, 29 U.S.C*

(6) The Court finds that
the transactions involv

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§404(a)(1)(A) and (B), 29 U.S.C. §1104(A)(1)(A) and (B).

ERISA §404(a)(1)(C), 29 U.S.C. §1104(A)(1)(C), further requires a plan fiduciary to diversify the investments of the plan so as to minimize the risk of large losses. The key principal behind the requirements of §404(a)(1)(C) is to prevent plan assets from being exposed to certain *shared risks* through a concentration of plan assets in a single investment or a single class of investments. *See*, Conference Committee Report No. 93-1280, 93d Cong. 2d Sess. (1974) at 304; *Marshall v. Teamsters Local 282, supra*, 458 F. Supp. 986, 990.

Based upon the evidence contained in the Plan ledgers and on the Form 5500 filed for 1975, as well as the trial testimony of Plan bookkeeper Doris Burleson, it appears that from January 1, 1975, until the sale of the Fort Worth property in 1979, between 85% and 90% of the Plan's assets were invested in non-interest bearing accounts or notes receivable from companies owned or controlled by Defendant Tommy Mercer. In December, 1979, when the court-appointed receiver took control of the Plan, its only assets, aside from these notes, were some U.S. Savings Bonds held in the names of individual participants; approximately $160 in cash found with the savings bonds in the Plan's safe deposit box, and a check for $58,482.36, representing the proceeds from the sale of the Fort Worth property originally owned by Heritage Investments.

It should be obvious that a concentration of 85% to 90% of the Plan's assets in a single class of investments is little or no diversification at all. With such a concentration of assets the risks of non-diversification, as contemplated by §404(a)(1)(C), are clearly present. In the present case, such risks turned out to be reality. *See, Marshall v. Local 282, supra*, wherein it was held a concentration of 36% of the plan's assets in one form of investment was a violation of ERISA §404(a)(1)(C).

(b) *ERISA §406, 29 U.S.C. §1106.*

[6] The Court finds that with respect to the transactions involved herein, all were maintained in violation of ERISA §406.

The transfer of assets from the Plan to the Trucking Co. clearly violated ERISA §§406(a)(1)(B) and (D). The Trucking Co. was an employer of employees covered by the Plan; accordingly it was a party in interest as defined in ERISA §3(14)(C), 29 U.S.C. §1002(14)(C). Thus, by causing these transfers to be made, the fiduciary either lent money (although there was no formal loan agreement indicating this was intended as a loan) to a party in interest in violation of §406(a)(1)(B) or, as is more likely, simply transferred assets to a party in interest, which is prohibited by §406(a)(1)(D).

It is clear that Defendant Tommy Mercer acted in this matter on behalf of his own interest and of a party (the Trucking Co.) whose interests were adverse to those of the Plan. Tommy Mercer was sole owner and president of the Trucking Co. at all times between January 1, 1975, and October, 1977, when the company filed for bankruptcy. Mr. Mercer admitted that the purpose of these transfers was to provide operating revenue for the Trucking Co. Moreover, the fact that many of these transfers were made just prior to the bankruptcy of the company supports the conclusion that these transfers were made for the benefit of the company rather than the Plan. Accordingly, this was a violation of ERISA §§406(b)(1) and (2).

It should be pointed out that the loans made to G.E.M. and Heritage Investments were entered into prior to the effective date of ERISA. However, the failure to require payment of interest on these loans constituted a further extension of of credit and transfer of Plan assets to parties in interest after January 1, 1975, in violation of ERISA §§406(a)(1)(B) and (D), 29 U.S.C. §§1106(a)(1)(B) and (D).

G.E.M. was a party in interest by virtue of the fact that Tommy Mercer was its exclusive owner (ERISA §3(14)(G), 29 U.S.C. §1002(14)(G). At all times after January 1, 1975, Heritage Investments was a sole proprietorship, wholly owned and operated by Tommy Mercer. As such, Heritage Investments

had no legal existence apart from Tommy Mercer with respect to possible ERISA violations. By making said loans to Heritage Investments, the Plan was in reality extending credit to Tommy Mercer, a party in interest pursuant to ERISA §3(14)(A), 29 U.S.C. §1002(14)(A).

As the court stated in *Freund v. Marshall, supra* at 637-638:

> Specifically, a plan fiduciary cannot, without violating §406(b)(1), use any of his fiduciary authority to cause the plan to make a loan to an entity in which he has an interest. Moreover, because the interests of a lender and a borrower are, by definition, adverse, a fiduciary cannot act in a loan transaction on behalf of a party borrowing from the plan without violating §406(b)(2).

With respect to the G.E.M. and Heritage loans, Tommy Mercer acted on both sides of the transaction. Such situations inherently give rise to a conflict of interest, as noted above in *Freund. Cutaiar v. Marshall,* 590 F.2d 523 [1 EBC 2153] (3rd Cir. 1979); *Freund v. Marshall, supra.* Accordingly, said transactions were in direct violation of ERISA §§406(b)(1) and (2), 29 U.S.C. §§1106(b)(1) and (2).

The evidence at trial showed that the loans made to Heritage Investments had been paid or substantially paid in December, 1979. This is immaterial to the Court's determination. Congress, in enacting ERISA §406 proscribed certain transactions which offer a "high potential for loss of plan assets or for *insider abuse*" (emphasis added). *Marshall v. Kelley, supra.* at 354. It is the mere existence of a conflict of interest which is proscribed by §406. The fact that a prohibited loan is or may be ultimately repaid, or is beneficial to the Plan, does not render the loan lawful. *Marshall v. Kelly, supra; M & R Inv. Co., Inc. v. Fitzsimmons,* 484 F. Supp. 1041 [2 EBC 2504] (D. Nev. 1980).

Judgment will be entered in accordance with this opinion ordering that:

1. Defendant Tommy Mercer be permanently enjoined from further serving as a fiduciary of this Plan and from serving any other Plan for a period of five years.

2. Defendant Tommy Mercer, having violated his various duties as a fiduciary, is adjudged liable to restore to the Plan the following:

(a) The full amount of the loan made on behalf of the Plan to G.E.M. in the principal amount of $241,366.26 and with interest thereon at the rate of six and one-fourth percent (6-¼%) per annum from January 1, 1974 to the date of this judgment and thereafter interest at the rate provided by law.

(b) The full amount of the loan made on behalf of the Plan to G.E.M. in the principal amount of $43,563.60 and with interest thereon at the rate of eight and one-half percent (8-½%) per annum from February 26, 1970 to the date of this judgment and thereafter interest at the rate provided by law.

(c) The sum of $23,339.88 representing the total of all transfers made from the Plan to the Trucking Co. just prior to the bankruptcy of the latter. Said obligation will bear interest at the prime rate of interest from October 1, 1977, until date of judgment and thereafter interest at the rate provided by law.

(d) Attorney's fees (incurred by Professional Services, Inc., in attempting to collect monies owed the Plan by Defendant's companies) and costs of court are hereby awarded to the Plaintiff. Professional Services, Inc., will provide this Court with an itemized list of said fees within ten (10) days of entry of this judgment.

3. Interest on this judgment will accrue at the legal rate from the date of judgment until paid.

4. Any monies recovered by the Plan in bankruptcy proceedings shall be applied to this judgment to the credit of Tommy Mercer.

5. Professional Services, Inc., will continue its appointment as the trustee of the T.E. Mercer Employees Retirement Plan until and unless it applies to the Court for appointment of a successor and shall accumulate the monies re-

ceived from Defendant pursua
Court's Order and distribute th
participants and beneficiarie
Plan according to the value
accounts.

URSIC v. BETHLEHEM

**U.S. District Cour
Western District of Penn**

WILLIAM B. URSIC v. BE
MINES, a Subsidiary of
Steel Corporation, THE
PLAN OF BETHLEHEM S
PORATION AND SUBSIDI
PANIES, and D.W. KEMP
Administrator, Civil Action
Feb. 1, 1983.

**ERISA — PROTECT
RIGHTS**

**Administration and E
— Interference with
Rights; Coercive
(► 40.90)**

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Judgment for former em

Stanford A. Segal, o
Segal & Koerner, of I
attorney for Ursic.

Carl H. Hellerstedt,
Reed & Armstrong, of
attorney for Bethlehem

Full Text of

DUMBAULD, Senior D
Plaintiff, William B.
action for violation o
[§510 of Act of Septe

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ceived from Defendant pursuant to the Court's Order and distribute them to the participants and beneficiaries of the Plan according to the value of their accounts.

URSIC v. BETHLEHEM MINES

U.S. District Court,
Western District of Pennsylvania

WILLIAM B. URSIC v. BETHLEHEM MINES, a Subsidiary of Bethlehem Steel Corporation, THE PENSION PLAN OF BETHLEHEM STEEL CORPORATION AND SUBSIDIARY COMPANIES, and D.W. KEMPKEN, Plan Administrator, Civil Action No. 81-086, Feb. 1, 1983.

ERISA — PROTECTION OF RIGHTS

Administration and Enforcement — Interference with Protected Rights; Coercive Interference (► 40.90)

Former employee is entitled to recover lump sum of accumulated pension benefits plus future payments where inescapable inference of evidence was that employee's discharge by employer was pretextual and contrived in order to prevent his receiving 30 year pension to which he would have been entitled if permitted to complete 30 years of service.

In former employee's action alleging violation of ERISA Section 510 for wrongful deprivation of pension rights. Judgment for former employee.

Stanford A. Segal, of Gatz, Cohen, Segal & Koerner, of Pittsburgh, Pa., attorney for Ursic.

Carl H. Hellerstedt, Jr., of Thorp, Reed & Armstrong, of Pittsburgh, Pa., attorney for Bethlehem Mines, et al.

Full Text of Opinion

DUMBAULD, Senior District Judge.

Plaintiff, William B. Ursic, brings this action for violation of 29 U.S.C. 1140 [§510 of Act of September 2, 1974, 88 Stat. 895, commonly known as ERISA] for wrongful deprivation of pension rights by contrived pretextual discharge prior to the vesting of such rights.

That section provides:

> It shall be unlawful for any person to discharge, fine, suspend, expel, discipline, or discriminate against a participant or beneficiary for exercising any right to which he is entitled under the provisions of an employee benefit plan, this subchapter, section 1201 of this title, or the Welfare and Pension Plans Disclosure Act, or for the purpose of interfering with the attainment of any right to which such participant may become entitled under the plan, this subchapter, or the Welfare and Pension Plans Disclosure Act .... The provisions of section 1132 of this title shall be applicable in the enforcement of this section.

29 U.S.C. 1132 authorizes civil actions by participants in the plan to enforce their rights or redress violations. Jurisdiction is given to District Courts by §132(e)(1). The Court in its discretion is empowered by §1132(g) to "allow a reasonable attorney's fee and costs of action to either party."

The Court's order of March 5, 1982, denying defendants' motion for partial summary judgment, held that by reason of his discharge on June 18, 1980, before he completed the thirty years of service necessary to qualify for a thirty year pension, plaintiff did not qualify literally under the terms of the plan and could recover only if he could establish that his discharge was pretextual and contrived by defendants in order to prevent his receiving the thirty year pension to which he would be entitled if permitted to complete the thirty year period of service. Non-jury trial on this issue was held January 4-6, 1983.

When discharged, plaintiff had worked 29 years, 5 months, and 11 days. His work record was good and he was highly regarded by his superiors (as testified by David Sparks, the division manager, and as also shown by performance appraisals, PX 5-8). He excelled particularly with respect to production. He displayed less aptitude with regard

Citation Search Result Rank 1 of 1 Database
OPINION NO. 93-35A FPEN-ERISA
Pens. Plan Guide (CCH) P 23,890F
(Cite as: 1993 WL 562217 (E.R.I.S.A.))

1 Ms. Roberta Casper Watson
Trenam, Simmons, Kemker, Scharf, Barkin, Frye & O'Neill
Attorneys at Law
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101 East Kennedy Blvd.
P. 0. Box 1102
Tampa, FL 33601-1102

December 23, 1993

ERISA SECTION:
408(b)(3)

Dear Ms. Watson:

This is in response to your letter requesting an advisory opinion regarding whether proceeds received from the sale of stock acquired with a loan which is exempt under section 408(b)(3) may be used to repay the loan if there is no formal pledge of the stock as security for the loan. In effect, you inquire whether Department of Labor Regulation 29 C.F.R. 2550.408b-3(e) would preclude repayment using such proceeds.

You represent that in late 1987 an employee stock ownership plan (the ESOP) executed a promissory note which was guaranteed by its corporate sponsor. The ESOP subsequently acquired corporate stock at an average purchase price of * * *. The stock was not formally pledged as security for the loan. In April, 1989 there was an unsolicited offer to purchase all the shares of the sponsor. After consideration by a "Special Independent Committee" of the sponsor's board of directors, the sponsor agreed to accept an offer of * * * a share. In connection with the offer, shares held in the ESOP's suspense account were tendered.

The tender offer was issued pursuant to agreements which further contemplated a merger of the purchaser into the sponsor. Under the merger agreement, all other shares held by the ESOP will be exchanged for * * * cash. Upon consummation of these agreements, the suspense account will contain approximately * * * in cash, with a * * * balance remaining on the loan. It is the desire of the Trustee and the Company that the cash held in the suspense account be used to prepay the loan in full and that the balance of the suspense account be allocated to participants' accounts.

Section 406(a)(1)(B) of ERISA prohibits the lending of money or other extension of credit, including a guarantee of a loan, [FN1] between a plan and a party in interest. An employer that sponsors a plan is a party in interest with respect to the plan, under section 3(14)(C) of ERISA. Therefore, a sponsor's guarantee of a loan to a plan would be prohibited in the absence of a statutory or administrative exemption.

Section 408(b)(3) of ERISA provides a conditional exemption for loans to employee stock ownership plans. Regulation section 2550.408b-3(e) interprets

his exemption and provides, in part, that:

No person entitled to payment under the exempt loan shall have any right to assets of the ESOP other than:

(1) Collateral given for the loan;

(2) Contributions (other than contributions of employer securities) that are made under an ESOP to meet its obligations under the loan; and

(3) Earnings attributable to such collateral and the investment of such contributions.

It is the view of the Department of Labor that while 2550.408b-3(e) precludes recourse to other than the above- enumerated assets of the ESOP by persons ntitled to repayment of a loan that is exempt under ERISA section 408(b)(3), it does not serve to limit the use of other assets by the fiduciary of an employee tock ownership plan to repay an exempt loan. Accordingly, the loan to the ESOP ould not fail to be exempt solely because the appropriate plan fiduciary used assets of the ESOP other than those enumerated in 2550.408b-3(e) to repay the oan.

***2** However, any such action would be subject to the general fiduciary rules of ERISA. In this regard the appropriate plan fiduciary should consider the application of ERISA sections 403, 404, and 406. Section 403(c)(1) of ERISA rovides, in part, that:

[T]he assets of a plan shall never inure to the benefit of any employer and shall be held for the exclusive purposes of providing benefits to participants n the plan and their beneficiaries and defraying reasonable expenses of administering the plan.

ERISA section 404(a)(1)(A) provides, in part, that:

[A] fiduciary shall discharge his (or her) duties solely in the interest of the participants and their beneficiaries and (A) for the exclusive purpose of (i) providing benefits to participants and their beneficiaries; and (ii) defraying reasonable expenses of administering the plan.

ERISA section 404(a)(1)(B) provides, in part, that a fiduciary shall discharge his or her duties:

[W]ith the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent [person] acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.

ERISA section 406(a)(1)(D) provides that, except as provided in section 408, a fiduciary with respect to a plan shall not cause the plan to engage in a transaction, if he or she knows or should know that such transaction constitutes a direct or indirect transfer to, or use by or for the benefit of, a party in interest, of any assets of the plan.

The appropriate plan fiduciary must consider the application of these provisions to the facts and circumstances of this case. In particular, the fiduciary must ascertain under the above-described circumstances whether the lender has recourse to employer securities in the suspense account (or proceeds received from the sale of such securities) in the event of default -- i.e., whether the securities serve as collateral for the loan. [FN2] In the absence of such a determination, repayment by the plan of the balance remaining on the loan would appear to violate ERISA sections 403(c)(1), 404(a)(1)(A),

)4(a)(1)(B) and 406(a)(1)(D) because, assuming the loan complied with the terms of 29 C.F.R. 2550.408b-3, the lender would have no right to employer securities held in the suspense account and the plan would have no legal obligation to repay the loan with the proceeds from the sale of the securities.

This letter constitutes an advisory opinion under ERISA Procedure 76-1. Accordingly, this letter is subject to the provisions of the Procedure including section 10 thereof relating to the effect of advisory opinions.

Sincerely,

ROBERT J. DOYLE
Director of Regulations and Interpretations

FN1. See Conference Report accompanying ERISA, H.R. Rep. No. 1280, 93rd Cong., 2d Sess. 308 (1974).

FN2. Notwithstanding collateralization of the loan by the unallocated employer securities in the suspense account, other fiduciary duties under Title I of ERISA may be implicated when considering the sale of such securities to service the exempt loan debt.

Office of Pension and Welfare Benefit Programs (E.R.I.S.A.)
U.S. Department of Labor
Opinion No. 93-35A, Pens. Plan Guide (CCH) P 23,890F, 1993 WL 562217 (E.R.I.S.A.)
END OF DOCUMENT

Citation Search Result Rank 1 of 1 Database
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The tender offer was issued pursuant to agreements which further contemplated a merger of the purchaser into the sponsor. Under the merger agreement, all other shares held by the ESOP will be exchanged for * * * cash. Upon consummation of these agreements, the suspense account will contain approximately * * * in cash, with a * * * balance remaining on the loan. It is the desire of the Trustee and the Company that the cash held in the suspense account be used to prepay the loan in full and that the balance of the suspense account be allocated to participants' accounts.

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this exemption and provides, in part, that:

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(3) Earnings attributable to such collateral and the investment of such contributions.

It is the view of the Department of Labor that while 2550.408b-3(e) precludes recourse to other than the above- enumerated assets of the ESOP by persons entitled to repayment of a loan that is exempt under ERISA section 408(b)(3), it does not serve to limit the use of other assets by the fiduciary of an employee stock ownership plan to repay an exempt loan. Accordingly, the loan to the ESOP would not fail to be exempt solely because the appropriate plan fiduciary used assets of the ESOP other than those enumerated in 2550.408b-3(e) to repay the loan.

***2** However, any such action would be subject to the general fiduciary rules of ERISA. In this regard the appropriate plan fiduciary should consider the application of ERISA sections 403, 404, and 406. Section 403(c)(1) of ERISA provides, in part, that:

[T]he assets of a plan shall never inure to the benefit of any employer and shall be held for the exclusive purposes of providing benefits to participants in the plan and their beneficiaries and defraying reasonable expenses of administering the plan.

ERISA section 404(a)(1)(A) provides, in part, that:

[A] fiduciary shall discharge his (or her) duties solely in the interest of the participants and their beneficiaries and (A) for the exclusive purpose of (i) providing benefits to participants and their beneficiaries; and (ii) defraying reasonable expenses of administering the plan.

ERISA section 404(a)(1)(B) provides, in part, that a fiduciary shall discharge his or her duties:

[W]ith the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent [person] acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.

ERISA section 406(a)(1)(D) provides that, except as provided in section 408, a fiduciary with respect to a plan shall not cause the plan to engage in a transaction, if he or she knows or should know that such transaction constitutes a direct or indirect transfer to, or use by or for the benefit of, a party in interest, of any assets of the plan.

The appropriate plan fiduciary must consider the application of these provisions to the facts and circumstances of this case. In particular, the fiduciary must ascertain under the above-described circumstances whether the lender has recourse to employer securities in the suspense account (or proceeds received from the sale of such securities) in the event of default -- i.e., whether the securities serve as collateral for the loan. [FN2] In the absence of such a determination, repayment by the plan of the balance remaining on the loan would appear to violate ERISA sections 403(c)(1), 404(a)(1)(A),

404(a)(1)(B) and 406(a)(1)(D) because, assuming the loan complied with the terms of 29 C.F.R. 2550.408b-3, the lender would have no right to employer securities held in the suspense account and the plan would have no legal obligation to repay the loan with the proceeds from the sale of the securities.

This letter constitutes an advisory opinion under ERISA Procedure 76-1. Accordingly, this letter is subject to the provisions of the Procedure including section 10 thereof relating to the effect of advisory opinions.

Sincerely,

ROBERT J. DOYLE
Director of Regulations and Interpretations

FN1. See Conference Report accompanying ERISA, H.R. Rep. No. 1280, 93rd Cong., 2d Sess. 308 (1974).

FN2. Notwithstanding collateralization of the loan by the unallocated employer securities in the suspense account, other fiduciary duties under Title I of ERISA may be implicated when considering the sale of such securities to service the exempt loan debt.

Office of Pension and Welfare Benefit Programs (E.R.I.S.A.)
U.S. Department of Labor
Opinion No. 93-35A, Pens. Plan Guide (CCH) P 23,890F, 1993 WL 562217 (E.R.I.S.A.)
END OF DOCUMENT

Citation Search Result Rank 1 of 1 Database
1997 WL 1824020 (P.W.B.A.) FPEN-PWBAIL
(Cite as: 1997 WL 1824020 (P.W.B.A.))

Pension and Welfare Benefits Administration (P.W.B.A.)
U.S. Department of Labor

*1 Kenneth C. Edgar, Jr.
Simpson, Thacher & Bartlett
425 Lexington Ave.
New York, N.Y. 10017-3954

December 17, 1997

Re: Identification No. A00420

Dear Mr. Edgar:

This is in response to your request for an advisory opinion of behalf of Lehman Brothers Holdings, Inc. ("Holdings"). Your request involves the application of the fiduciary provisions of the Employee Retirement Income Security Act of 1974 ("ERISA") to the sale of the unallocated shares held in the suspense account of the Holdings Employee Stock Ownership Plan ("the ESOP") to repay the outstanding ESOP loan balance following termination of the ESOP.

You represent that the Holdings Employee Stock Ownership Plan ("the ESOP") was established in 1987 by Holdings. The ESOP was a qualified plan under section 401(a) of the Internal Revenue Code of 1986 ("the Code"). The ESOP met the definition of ESOP in ERISA section 407(d)(6) and Code section 4975(e)(7). As of December 31, 1993, the ESOP was terminated subject to the receipt of a favorable determination letter from the Internal Revenue Service. No contributions were made to the ESOP by Holdings after that date.

You further represent that the trust agreement entered into by the ESOP trustee and Holdings on May 14, 1987 and the ESOP plan document both contain leveraging provisions which permit the ESOP trustee to cause the ESOP to borrow funds through loans intended to comply with ERISA section 408(b)(3) and Code section 4975(d)(3). In 1987, the ESOP borrowed $32.2 million from Holdings to purchase one million shares of Shearson Lehman Brothers ("Shearson") common stock, which constituted qualifying employer securities under ERISA section 407(d)(5) and Code section 4975(e)(8). As of September 29, 1994, following a series of corporate merger and spin-off transactions, the ESOP was invested in American Express and Holdings common stock, both of which you represent are qualifying employer securities. The approximate market value of unallocated American Express and Holdings common stock held in the ESOP suspense account ("the unallocated shares") was approximately $3.77 million as of September 29, 1994. The principal amount of the outstanding ESOP loan between the ESOP and Holdings was $8.2 million as of October 21, 1994. Pursuant to the promissory note entered into in May 1987 by the ESOP trustee, a payment of $4 million of principal and an unspecified interest amount were due on May 16, 1994. The ESOP trustee did not pay the May installment and the ESOP is currently in default on its loan payments to Holdings. Holdings desires the ESOP trustee to use the unallocated

shares or the proceeds thereof to repay the outstanding principal balance of the ESOP loan.

You represent further that the ESOP Promissory note is subject to full payment in the event that unallocated shares of Holdings are sold or the ESOP is terminated. Moreover, the ESOP has provided since its inception in 1987 that upon termination of the ESOP, inter alia, the unallocated shares must be sold to the extent necessary to satisfy any then outstanding ESOP loan and the proceeds of the sale of any such unallocated shares must be paid to the ESOP lender. The ESOP Trust agreement contains language incorporating these provisions by reference. You present argument that although these shares were not formally pledged, these provisions read together evidence a security interest under New York State law.

*2 The questions that you ask concerning the determination by the ESOP trustees as to whether the unallocated shares or the proceeds from the sale of those shares can be used to satisfy the outstanding ESOP debt involve factual considerations and issues of state law with respect to which the Department ordinarily will not provide an opinion. The Department expects the responsible plan fiduciaries to make such determinations on the basis of all the relevant facts and circumstances. Therefore, we are responding to your request in the form of an information letter, which is described in section 3.01 of ERISA Procedure 76-1, 41 Fed. Reg. 36281 (Aug. 27, 1976).

Section 406(a)(1)(B) of ERISA prohibits the lending of money or other extension of credit, including a guarantee of a loan, between a plan and a party in interest. Section 3(14)(C) of ERISA provides that than employer which sponsors a plan is a party in interest with respect to that plan. Therefore, a sponsor's loan to a plan would be prohibited in the absence of a statutory or administrative exemption.

Section 408(b)(3) of ERISA provides a conditional exemption for loans to employee stock ownership plans. The Department interprets section 408(b)(3) to provide that no person entitled to payment under the exempt loan shall have any rights to the assets of the ESOP other than:

(1) Collateral given for the loan;

(2) Contributions (other than contributions of the employer securities) that are made under an ESOP to meet its obligations under the loan; and

(3) Earnings attributable to such collateral and the investment of such contributions.

29 C.F.R. 2550.408b-3(e). The Department believes that the ESOP loan would not fail to be exempt solely because the appropriate plan fiduciary used assets of the ESOP other than those enumerated in section 2550.408-3(e) to repay the loan. Nonetheless, the use of any assets other than those enumerated in that part of the regulation would be subject to the general fiduciary rules of ERISA. See Section 403(c)(1) (assets of a plan shall never inure to the benefit of any employer and shall be held for the exclusive purposes of providing benefits to participants in the plan and their beneficiaries and defraying reasonable expenses of administering the plan); section 404(a)(1) (fiduciary shall discharge his or her duties solely in the interest of the participants and their beneficiaries and for the exclusive purpose of providing benefits and defraying reasonable expenses of administering the plan and shall discharge those duties

with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims); section 406(a)(1)(D) (except as provided in section 408, a fiduciary with respect to a plan shall not cause the plan to engage in a transaction, if he or she knows or should know that such transaction constitutes a direct or indirect transfer to, or use by or for the benefit of, a party in interest, of any assets of the plan).

*3 As the Department explained in Advisory Opinion **93-35A** (December 23, 1993), the appropriate plan fiduciary must consider whether the lender has a security interest in the employer securities in the suspense account (or the proceeds from the sale thereof) in the event of default. In the absence of a determination by the plan fiduciary that the lender has an enforceable legal interest in the unallocated employer securities in the suspense account, repayment by the plan of the balance remaining on the loan through the sale or exchange of such securities would appear to violate ERISA sections 403(c)(1), 404(a)(1)(A), 404(a)(1)(B) and 406(a)(1)(D). [FN1] The question of whether the lender has a security interest in the employer securities in the suspense account (or the proceeds from the sale thereof) is a question of state law interpretation.

I hope this information is of assistance to you.

Sincerely,

Bette Briggs
Chief, Division of Fiduciary Interpretations
Office of Regulations and Interpretations

FN1. Even if the lender has an unambiguously stated security interest in the unallocated employer securities in the suspense account, other fiduciary duties under Title I of ERISA, such as compliance with the terms of plan documents under section 404(a)(1)(D), may be implicated when considering the sale of such securities to service the exempt loan debt.

1997 WL 1824020 (P.W.B.A.)
END OF DOCUMENT

Citation
PLR 9416043
1994 WL 141568 (IRS PLR)

Search Result

Rank 1 of 2

Database
FTX-PLR

Internal Revenue Service (I.R.S.)

Private Letter Ruling

Issue: April 22, 1994
January 28, 1994

Section 4975 -- Tax on Prohibited Transactions
4975.00-00 Tax on Prohibited Transactions
4975.04-00 Statutory Exemptions
4975.04-02 ESOP Loans

CP:E:EP:R:10

LEGEND

Company M: ***
Company N: ***
Company O: ***
Plan X : ***
$ A : ***
$ B : ***
$ C : ***
$ x : ***
$ y : ***
$ z : ***

Dear ***

In a letter dated ***, amended and supplemented by letters dated ***, *** and *** your authorized representative requested a ruling on your behalf concerning the federal income tax consequences of a proposed repayment of an exempt loan to Plan X.

Plan X (an ESOP) was established by Company M effective July 1, 1978. Plan X is intended to comply with sections 401(a), 501(a), and 4975(e)(7) of the Internal Revenue Code and last received a favorable determination letter dated October 6, 1986. Plan X contains leveraging provisions which permit the trustee to cause Plan X to borrow funds through a loan which is intended to comply with the requirements of section 4975(d)(3) of the Code.

On *** Plan X borrowed $A million in order to purchase shares of Company M common stock, which is publicly traded. Plan X used the proceeds from the loan to acquire common stock of Company M with an average purchase price of $x per share. The Company M common stock is held in a suspense account and is released for allocation to the accounts of plan participants in proportion to payments on principal and interest under the terms of the loan. The note provides Plan X the

option to prepay any or all of the then outstanding principal indebtedness, without penalty, and with interest to the date of prepayment only. None of the assets of Plan X were formally pledged with respect to this loan.

On ***, Company N made an unsolicited offer to purchase all of the outstanding shares of Company M common stock, including those in Plan X, for $z per share. You state that this amount represented a substantial premium over the value of the Company M employer securities of $y per share as listed on the New York Stock Exchange on the last full trading date prior to the first public announcement of the tender offer.

In connection with the sale, Company M, as trustee of Plan X, tendered the stock in the suspense account so that the suspense account now contains only the proceeds from the sale of the stock, approximately $B million. The remaining balance on the loan is approximately $C million.

It is the intention of the Plan X trustee and Company M that the cash held in the suspense account be used to prepay the loan in full, and that the balance remaining in the suspense account be allocated to participant accounts in accordance with the terms of Plan X. Company N does not intend to continue to maintain Plan X or establish another ESOP for its employees. Consequently, as soon as administratively practicable after the assets are distributed, Plan X will be terminated and all participants will be fully vested in their account balances on the termination date.

Based on the foregoing, your authorized representative has requested a ruling that the proceeds from the sale, pursuant to the offer and merger, of the unallocated common stock in the Plan X suspense account could be used to prepay the outstanding principal balance without causing the loan to fail to meet the exemption provided by section 4975(d)(3) of the Code.

An ESOP is an arrangement designed to invest primarily in employer securities. An ESOP must be part of a stock bonus plan qualified under section 401(a) of the Code, or a stock bonus plan and money purchase pension plan, both of which are qualified under section 401(a). A leveraged ESOP borrows funds which it uses to purchase employer securities, usually from the employer. The ESOP loan is generally guaranteed by the employer. The acquired employer securities are held in a suspense account pending allocation to the accounts of the plan participants according to the rules of section 54.4975-11(d) of the Income Tax Regulations. The ESOP generally uses employer contributions to the plan to repay the exempt loan.

Pursuant to section 4975(d)(3)(A) of the Code, an ESOP loan will be exempt from the prohibited transaction tax only if the loan is primarily for the benefit of plan participants and beneficiaries. Under section 54.4975-7(b)(3) of the regulations, whether a loan satisfies the "primary benefit requirement" will be determined based on all the surrounding facts and circumstances.

Among the facts relevant to the primary benefit requirements are whether the transaction promotes employee ownership of employer stock, whether contributions to an ESOP that is part of a stock bonus plan are recurring and substantial, and the extent to which the method of repayment of the exempt loan benefits the employees. All aspects of the loan transaction, including the method of repayment, will be scrutinized to see whether the primary benefit requirement is satisfied.

With respect to repayment of an exempt loan, section 54.4975-7(b)(5) of the

regulations indicates that the employer has the primary responsibility for repayment through contributions to the plan. Section 54.4975-7(b)(6) provides for repayment of an exempt loan in the event of default. However, the exemption provided by section 4975(d)(3) of the Code, and described in the associated regulations will not fail to be met merely because a plan trustee sells employer securities and repays an exempt loan, not in default, if such transaction satisfies the "primary benefit requirement" based on all the surrounding facts and circumstances.

In the present case, no additional employer securities will be acquired subsequent to the tender offer because Company N has no intention of continuing to maintain the ESOP. Furthermore, a substantial premium was paid for the Company M employer securities. After the loan is repaid, the balance remaining in the suspense account will be distributed to Plan X participants and Plan X will then be terminated.

Accordingly, with respect to your requested ruling, we conclude, in the present case, that the proceeds from the sale, pursuant to the offer and merger, of the unallocated common stock in the Plan X suspense account can be used to repay the outstanding principal balance on the loan without causing the loan to fail to meet the exemption provided by section 4975(d)(3) of the Code.

Section 415(a) of the Code provides that a trust which is part of a pension, profit sharing or stock bonus plan will not constitute a qualified trust under section 401(a) if, in the case of a defined contribution plan, contributions and other additions under the plan with respect to any participant for any taxable year exceed the limitations of subsection (c). Section 415(c)(1) provides that contributions and other additions with respect to a participant exceed the limitations of this subsection if, when expressed as an annual addition (as defined below), such annual addition is greater than the lesser of $30,000 or 25 percent of the participant's compensation. Under section 415(c)(2), an annual addition is defined as the sum for any year of employer contributions, employee contributions and forfeitures.

We also conclude that amounts allocated to participant accounts as a result of the loan repayment constitute an annual addition for purposes of section 415 of the Code equal to the cost (basis) of the stock at the time it was contributed to the plan or otherwise acquired with the exempt loan proceeds. The amount of the annual addition to each participant under section 415 will be equal to the product of the dollar amount allocated to each participant's account multiplied by a fraction in which the stock's basis is the numerator and the sales price is the denominator.

We express no opinion as to whether the proposed termination of Plan X complies with the requirements of sections 401(a) and 4975(e)(7) of the Code. This matter is within the jurisdiction of the appropriate key district office.

We note that the Department of Labor has jurisdiction with respect to the provisions of part 4 of Title I of the Employee Retirement Income security Act of 1974 ("ERISA"), including the requirement in section 404(a)(1)(B) of ERISA that fiduciaries discharge their duties prudently. Therefore, we express no opinion as to whether the subject transactions are consistent with such provisions.

The above ruling is based on the representations made herein and the assumption that Plan X is qualified under sections 401(a) and 4975(e)(7) of the

Code and its related trust was tax-exempt under section 501(a), at all times pertinent to this ruling request. This ruling is also based on the assumption that the amounts allocated to participants after the loan is prepaid do not exceed the limitations under section 415.

In accordance with a power of attorney on file with this office, a copy of this ruling is being sent to your authorized representative.

Sincerely yours,

John G. Riddle, Jr.
Acting Chief
Employee Plans Rulings Branch
Enclosures:
Deleted copy of this letter
Notice of Intention to Disclose

This document may not be used or cited as precedent. Section 6110(j)(3) of the Internal Revenue Code.

PLR 9416,043, 1994 WL 141568 (IRS PLR)
END OF DOCUMENT

Citation
PLR 8044074
1980 WL 135505 (IRS PLR)

Search Result

Rank 22 of 23

Database
FTX-PLR

Internal Revenue Service (I.R.S.)

Private Letter Ruling

August 11, 1980

Section 4975 -- Tax on Prohibited Transactions
4975.00-00 Tax on Prohibited Transactions
4975.04-00 Exemptions

***
***

Legend:

Employer = ***
Plan = ***
Corporation A = ***
Parent = ***
Bank A = ***
Bank B = ***
Bank C = ***

Gentlemen:

By letter dated April 9, 1980, you requested a ruling on the Federal tax consequences of a proposed transaction concerning the subject pension plan. The transaction relates to the prepayment by the Plan of certain exempt loans.

The relevant facts as represented may be summarized as follows. The Plan was adopted by the Employer in 1969 as a thrift plan intended to meet the requirements for tax qualification under section 401(a) of the Internal Revenue Code. The Plan was amended in 1974 with the express intention that it become an employee stock ownership plan defined in section 4975(e)(7) of the Code while maintaining certain thrift plan features (i.e., mandatory employee contributions which are matched to the extent of, at least, 25 percent by Employer contributions plus additional voluntary employee contributions which are unmatched). The Plan maintains three separate accounts--an 'Employee Account' holding Employer common stock purchased with employee contributions and earnings thereon, an 'Employer Account' holding Employer common stock purchased with Employer contributions and earnings thereon, and an 'Unallocated Account' holding Employer common stock purchased with the proceeds of an exempt loan which are not yet allocated to the Employer contributions accounts of Plan participants.

The Plan first utilized its leveraging authority to acquire Employer common stock in 1976. It borrowed the necessary funds from Bank A, and as of December 31, 1976, the Plan had an outstanding loan balance with Bank A in the principal

amount of $6.75x. (Hereafter, this loan is referred to as the '1976 loan.')

In April, 1978, the Plan established a $10x joint line of credit with Banks B and C; the Employer guaranteed any borrowings by the Plan. Later in April, the Plan drew on the line of credit in the amount of $5.57x and with the loan proceeds paid off the 1976 loan. In May, 1978, the Plan drew again on the line of credit in the amount of $3.39x and with the loan proceeds purchased additional Employer common stock. Twice in November (on the 14th and 24th), 1978, the Plan drew further on the line of credit in the amounts of, respectively, $1.01x and $0.01x and with the proceeds of the loans purchased additional Employer common stock. (Hereafter, the four loans which occurred in 1978 (the one in April, the one in May, and the two in November) are referred to as the '1978 loans.') As of January 31, 1980, the total outstanding balance on the 1978 loans was $8.63x.

Pursuant to a proposed combination of Employer and Corporation A, Parent, a newly-formed holding company, will own all the outstanding common stock of both Corporation A and Employer. It is anticipated that Corporation A and Employer, as subsidiaries of Parent, will continue to be engaged in their present businesses without material change. Under the terms of the proposed combination, each holder of Employer common stock will receive $33 in cash plus three-fourths of one share of Parent common stock for each share of Employer common stock. It is proposed that upon effectiveness of the combination:

(1) All proceeds of the combination received by the Plan (i.e., cash and common stock) will be credited to the Plan account which gave rise to such proceeds,

(2) A portion of the cash proceeds credited to the 'Unallocated Account' will be utilized to repay in its entirety the total outstanding balance on the 1978 loans,

(3) Upon full satisfaction of the 1978 loans, all remaining assets in the 'Unallocated Account' (consisting of both cash and Parent common stock) will be allocated to Plan participants on the basis of current compensation or in a manner approved by the appropriate District Director's office,

(4) The Plan will be amended to provide that as soon as practicable following the Plan's receipt and allocation of the proceeds of the combination, each participant will be afforded an election with respect to the investment of the cash proceeds of the combination credited to his various Plan accounts in a fixed income fund or a commingled equity fund and, perhaps, a fund which will invest solely in Parent common stock,

(5) The Plan will be amended further to provide that the trustee is no longer permitted to leverage its purchase of employer securities under the Plan.

Following these events, Parent will cause Employer to either continue to maintain the Plan in essentially its present form on a non-leveraged basis or, alternatively, freeze the Plan and maintain it as a wasting trust. In the latter case, Parent will cause Employer to establish a new thrift plan containing provisions substantially identical to the Plan which will cover all present participants who remain in the Employer's employ.

You have requested a ruling to the effect that the Plan's use of a portion of the cash proceeds of the proposed combination credited to the 'Unallocated Account' to repay the total outstanding balance on the 1978 loans will not violate section 54.4975--7(b)(5) of the Pension Excise Tax Regulations (the

Regulations).

Section 54.4975--7(b)(5) of the Regulations provides, in pertinent part, that

No person entitled to payment under the exempt loan shall have any right to assets of the ESOP other than:

(i) Collateral given for the loan,

(ii) Contributions (other than contributions of employer securities) that are made under an ESOP to meet its obligations under the loan, and

(iii) Earnings attributable to such collateral and the investment of such contributions.

The payments made with respect to an exempt loan by the ESOP during a plan year must not exceed an amount equal to the sum of such contributions and earnings received during or prior to the year less such payments in prior years.

We hold that the prepayment by an ESOP of an exempt loan made to the ESOP is consistent with the above quoted language of section 54.4975--7(b)(5) of the Regulations. This section of the Regulations does not establish a per se prohibition against exempt loan prepayments by an ESOP. It requires that if an ESOP contemplates prepaying an exempt loan, the funds used to prepay the loan must be limited to the assets (e.g., qualifying employer securities) acquired in the exempt loan transaction, whether or not those assets collateralized the exempt loan, plus income attributable to those assets (e.g., dividends, proceeds from a subsequent sale of the assets). In prepaying the loan, in other words, the ESOP may not use its other general assets.

Here, the funds that will be used to prepay the 1978 loans originate solely from the sale, pursuant to the proposed combination, of the Employer common stock which was acquired in the exempt loan transaction and is held in the Plan's 'Unallocated Account.' The Plan's other general assets will not be used to prepay the loans. Therefore, the Plan's use of a portion of the cash proceeds of the proposed combination credited to the 'Unallocated Account' to repay the total outstanding balance on the 1978 loans is consistent with section 54.4975--7(b)(5) of the Regulations.

No opinion is expressed whether the Plan constitutes an employee stock ownership plan within the meaning of section 4975(e)(7) of the Code or whether the subject loans constitute exempt loans within the meaning of section 54.4975--7(b)(1)(iii) of the Regulations. Also, no opinion is expressed whether the acquisition by the Plan of cash and Parent common stock in exchange for Employer common stock pursuant to the proposed combination is exempt from the excise taxes imposed by sections 4975(a) and (b) of the Code by reason of section 4975(d)(13) of the Code and section 408(e) of the Employee Retirement Income Security Act of 1974 (ERISA).

We have conferred with representatives of the Department of Labor, and they concur in the views set forth above as they apply to Labor Regulation section 2550.408b--3. However, they also advise that they are expressing no opinion whether the above described repayment of the 1978 loans would satisfy the general fiduciary requirements of section 404(a)(1) of ERISA.

We hope this information will be helpful to you. In accordance with the powers of attorney on file in this office, a copy of this letter is being sent to your authorized representatives.

Sincerely yours,

PLR 8044074

(Signed) R. E. Withers
Chief
Employee Plans Technical Branch

This document may not be used or cited as precedent. Section 6110(j)(3) of the Internal Revenue Code.

PLR 8044,074, 1980 WL 135505 (IRS PLR)
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