No. 05-1010

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

IN RE MERRIMAC PAPER COMPANY, INC.,
Debtor

RALPH HARRISON,
Defendant-Appellant
v.

MERRIMAC PAPER COMPANY, INC.,
Plaintiff-Appellee

On Appeal from the United States District Court
for the District of Massachusetts

BRIEF FOR THE SECRETARY OF LABOR AS AMICUS CURIAE SUPPORTING APPELLANT FOR REVERSAL

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STATEMENT OF INTEREST

This is a case of first impression in the courts of appeals regarding the subordination of ERISA claims in bankruptcy. The Secretary of Labor has primary authority to interpret and enforce Title I of the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. § 1001 et seq., including authority to bring civil actions for breach of fiduciary duty to employee benefit plans. Corporate bankruptcies often put plan participants at heightened risk of losing funds accumulated for their retirement or health care. For instance, a corporate bankruptcy may leave plans holding large amounts of worthless company stock, sometimes acquired or held as a result of breaches of fiduciary duty. Therefore, the Secretary has a strong interest in ensuring that the subordination provisions of the Bankruptcy Code are not misapplied to subordinate ERISA claims brought by plan participants, beneficiaries, or the Secretary herself, merely because the claims have some relationship to a plan's holdings of employer stock.

STATEMENT OF THE ISSUES

This case involves bankruptcy claims by a retired participant in an ERISA-covered employee stock ownership plan (ESOP), who took a distribution of his plan benefits in company stock and "put" (sold) it back to the plan sponsor in exchange for a promissory note, part of which remained unpaid when the sponsor entered Chapter 11 reorganization proceedings. The questions presented are:

1. Whether the participant's ERISA claims for benefits and fiduciary breach are subject to mandatory subordination under 11 U.S.C. § 510(b) as claims "for damages arising from the purchase or sale" of a security of the debtor.

2. Whether his ERISA claims or contract claims for non-payment of the note are subject to equitable subordination under 11 U.S.C. § 510(c) absent any inequitable conduct.

STATEMENT OF THE CASE

A. Statement of the facts

Defendant-appellant Ralph Harrison is a former employee of plaintiff-appellee Merrimac Paper Company (MPC or Merrimac), which is now the debtor in a Chapter 11 proceeding. Harrison worked for Merrimac from 1963 to 1999. MPC sponsored an ESOP, which provides that participants receive a distribution of their Merrimac stock upon separation from employment. The plan gives participants a right to sell or "put" the stock back to the company in exchange for cash. App. 162-63, 360-61.

When Harrison retired, his individual account in the ESOP was credited with approximately 6% of MPC's common stock, an amount then valued at $1,116,200. After he exercised his put option, MPC made an initial payment of $200,000 on January 1, 2000. On July 19, 2000, MPC gave Harrison a promissory note for the balance of his account, $916,300, with 8.5% interest, secured by the shares of

MPC common stock that Harrison previously owned through the ESOP. The note was payable in three equal annual installments. Harrison received the first installment payment of $343,203 on January 4, 2001, but received no payments thereafter. App. 163, 360.

On September 6, 2002, Harrison brought a claim against MPC in state court for breach of contract in failing to pay the balance due on his promissory note. On September 12, 2002, he obtained an attachment in the amount of $610,000 on real property owned by MPC. On January 8, 2003, Harrison brought an ERISA action in federal district court against MPC, the ESOP, and four individuals alleged to be ERISA fiduciaries. App. 163-64, 360. The ERISA action included a benefit claim under 29 U.S.C. § 1132(a)(1)(B), asserting that defendants unlawfully denied plan benefits by failing to pay the balance due on the promissory note and by failing to provide "adequate security" on the note as required by the plan. Harrison also sued MPC for fiduciary breach under 29 U.S.C. §§ 1132(a)(2) and 1132(a)(3). He claimed, among other things, that MPC breached its fiduciary duties under ERISA, see 29 U.S.C. § 1104(a)(1)(A), (B), (D), by failing to provide adequate security for the note. Eggert v. MPC, No. 03-cv-10048-MLW, Third Am. Compl. 8-9 (filed Sept. 1, 2004 D. Mass.) (attached as Addendum A to this brief). The district court denied a motion to dismiss for lack of standing, holding that Harrison's rights under the put option, including the right to adequate security, could be

characterized as benefits under the plan, and thus gave rise to a colorable claim for vested benefits for standing purposes under Firestone Tire & Rubber Co. v. Bruch, 489 U.S. 101 (1989). No. 03-cv-10048-MLW, Mem. & Order 31, 33-34 (filed Mar. 31, 2004) (attached as Addendum B).

B. The bankruptcy court decision

On March 17, 2003, MPC filed a voluntary petition under Chapter 11 of the Bankruptcy Code. On June 20, 2003, MPC commenced an adversary action against Harrison in the bankruptcy court, seeking (as relevant here): mandatory subordination of Harrison's claims under 11 U.S.C. § 510(b), equitable subordination of Harrison's claims under section 510(c)(1), and avoidance of Harrison's lien on MPC property under section 510(c)(2). App. 112, 162, 164, 172-81.

The bankruptcy court addressed the ERISA claims and the contract claims separately under section 510(b). It declined to subordinate the contract claims, reasoning that claims for the balance due on a promissory note neither fall within the plain language of that provision nor bear any relationship to its purpose because the claimants are no longer shareholders. App. 173-74. However, it did subordinate the ERISA claims, explaining that "review of the ERISA Complaint supports that these claims are for damages that arise from their sale of stock to Merrimac." App. 174-75. The court also relied in part on In re Lenco, Inc., 116

B.R. 141 (Bankr. E.D. Mo. 1990), where the court subordinated an ERISA claim under section 510(b), and noted "ERISA's express language that it is not to be interpreted to supersede another federal law." App. 175-76.

The bankruptcy court subordinated both the contract and ERISA claims under section 510(c), although it did not discuss the ERISA claims separately. Despite the Supreme Court's disapproval of categorical subordination under section 510(c) in United States v. Noland, 517 U.S. 535 (1996), the bankruptcy court concluded that one of the "principles of equitable subordination" codified by section 510(c) is the categorical subordination of stock redemption claims. After subordinating Harrison's claims under section 510(c)(1), the court transferred his lien on MPC real property to the bankruptcy estate under section 510(c)(2). App. 176-80.

C. The district court decision

The district court affirmed. Regarding the state law claims under section 510(b), it observed that "Appellee does not contest the ruling of the Bankruptcy Court that Appellants' claims arising from default under the Notes are not subject to subordination under § 510(b)." App. 374. Accordingly, it did not reach that question. As to the ERISA claims, the district court agreed with the bankruptcy court that "the only conceivable basis for Appellants' ERISA claims is their sale of stock" and that "ERISA does not override the express language of § 510(b)."

Thus, the district court affirmed mandatory subordination of the ERISA claims under section 510(b). App. 374, 375.

With respect to section 510(c), the district court noted that this Court has not addressed equitable subordination of claims arising from stock repurchase agreements since the Bankruptcy Code was enacted. It also acknowledged that this Court has adopted a widely-accepted test for equitable subordination that requires inequitable conduct by the claimant. App. 368. Nevertheless, it agreed with the bankruptcy court that Noland did not supersede the earlier First Circuit cases equitably subordinating stock redemption claims as a class. In its view, "stockholders of a corporation do not become debt creditors or stand on equal footing with trade or other creditors by virtue of selling their stock back to the corporation . . . because a corporation acquires nothing of value when it purchases its own stock. . . . A stockholder who accepts a promissory note in payment for his stock assumes the risk that the corporation may be insolvent when the note becomes due." App. 370.

The district court gave short shrift to the ERISA claims, first stating (incorrectly) that "the only claims Appellants assert in the instant action are for non-payment of their Notes, claims which indisputably are governed by the bankruptcy laws." App. 371. The court added that "Appellants' conclusory statements about the equities of this particular case do not extend to ERISA the

authority to trump the bankruptcy laws." Id. In its view, "application of the bankruptcy laws, and specifically 11 U.S.C. § 510, is not altered by the fact that Appellants may have underlying claims based on ERISA." Id. The court also affirmed the transfer of Harrison's lien to the bankruptcy estate under 11 U.S.C. § 510(c)(2). App. 372.

SUMMARY OF ARGUMENT

Harrison's ERISA claims are not subject to mandatory subordination under section 510(b) of the Bankruptcy Code. His claim for benefits is simply another way of pleading his claim for the balance due on the note, and his fiduciary breach claim concerns Merrimac's failure to provide adequate security for the note. Neither claim seeks damages arising from the purchase or sale of a security.

More generally, ERISA claims do not arise from the purchase or sale of a security within the meaning of section 510(b). Section 510(b) was aimed at securities law claims, not ERISA claims, and participants in ERISA plans do not assume the same risks as equity investors. Also, ERISA claims do not seek damages; they seek either plan benefits or equitable relief for breaches of fiduciary duty.

Finally, Harrison's claims are not subject to equitable subordination under section 510(c) of the Bankruptcy Code. The lower courts ignored binding

Supreme Court precedent by categorically subordinating his claims as stock redemption claims, and there is no suggestion of inequitable conduct on his part.

ARGUMENT

I. HARRISON'S ERISA CLAIMS ARE NOT SUBJECT TO MANDATORY SUBORDINATION UNDER THE BANKRUPTCY CODE

Section 510(b) of the Bankruptcy Code requires mandatory subordination of "a claim . . . for damages arising from the purchase or sale" of a security of the debtor, and specifies that, "if such security is common stock, such claim has the same priority as common stock." 11 U.S.C. § 510(b). The question before this Court is whether Harrison's ERISA claims are claims for damages arising from the purchase or sale of a security within the meaning of this provision. The Secretary submits that they are not.

A. Even if some ERISA claims fall within section 510(b) of the Bankruptcy Code, Harrison's claims do not

The ERISA claims in this case are limited in scope – Harrison sought benefits from the ESOP, and alleged a breach of fiduciary duty in failing to provide adequate security for his promissory note. Even assuming, arguendo, that section 510(b) applies to some ERISA claims, it does not apply to the claims in this case because they do not arise from investment decisions by a plan fiduciary, but rather from Merrimac's failure to pay benefits due under the plan, and to provide adequate collateral for Harrison's promissory note as required by ERISA.

The lower courts have already held that section 510(b) does not apply to Harrison's state law claim for unpaid installments due on the note from Merrimac.[1] His ERISA benefit claim seems to be just another way of pleading his claim on the note, as the only relief he seeks in the benefit claim is the value of the unpaid installments and "adequate security" for those payments under the terms of the plan. This claim is pleaded in the alternative because it can be conceptualized in two ways. That is, if Harrison received a complete distribution of his plan benefits in the form of company stock, and then sold the stock back to the company under the put option in his plan, his claim can be treated as a state law contract claim for nonpayment of the note. On the other hand, if the installment payments under the note are themselves viewed as a cash distribution of his benefits in the ESOP, his claim is one for ERISA benefits due and unpaid. In neither case, however, can the claim be viewed as a claim for damages arising from any act or omission affecting his investment in company stock.

Nor do Harrison's fiduciary breach claims seek "damages arising from the purchase or sale of . . . a security" of the debtor within the meaning of section

[1] Because MPC has not appealed that determination, Harrison suggests that this Court may not need to reach the question of the subordination of his ERISA claims under section 510(b) in order to decide this appeal, but may instead merely consider whether the bankruptcy court acted within its discretion in subordinating the ERISA and state law claims under section 510(c). Harrison Br. 23-24 n.6. In addition, MPC argues (Br. 26-28) that Harrison never adequately asserted or preserved any ERISA claims in the bankruptcy proceedings. The Department expresses no opinion on that question.

510(b). Harrison seeks adequate security for his note ((as required by the Internal Revenue Code, ERISA regulations, see infra p. 28 n.8, and the plan), and resulting priority over other creditors in the bankruptcy proceeding. In effect, he argues that, if MPC had followed the terms of the plan's put option, his note would have been secured by MPC real property or other adequate security in the first place, as it was after he obtained the attachment in state court. Thus, Harrison's fiduciary breach claim in the bankruptcy proceeding is not a claim for "damages," but rather an equitable claim – he asks the court, sitting in equity, to honor the maxim that "equity treats as done that which in good conscience should be done." In re Cambridge Biotech Corp., 186 F.3d 1356, 1366 (Fed. Cir. 1999). The ERISA claim can also be viewed as an equitable defense in the bankruptcy proceeding, defending against subordination of his benefit claim and associated lien in bankruptcy. Moreover, because the claim seeks to retain an identifiable res as relief for fiduciary breach (Harrison's state court lien on MPC real property), the remedy sought fits within the Supreme Court's description of equitable restitution in Great-West Life & Annuity Insurance Co. v. Knudson, 534 U.S. 204 (2002). That is, it seeks "not to impose personal liability on the defendant [MPC], but to restore to the plaintiff particular funds or property in the defendant's possession [Harrison's attachment of MPC's real property, which is otherwise part of the bankruptcy estate]." Id. at 214.

B. ERISA claims are not claims arising from the purchase or sale of a security within the meaning of section 510(b) of the Bankruptcy Code

More generally, we believe that ERISA claims for fiduciary breaches related to a plan's holdings in company stock are not claims "arising from the purchase or sale of . . . a security" under section 510(b). Such an action does not fall within the ambit of section 510(b) for two related reasons. First, an ERISA plan participant is not similarly situated to an ordinary shareholder. An ERISA participant does not assume the same risks as ordinary equity investors, the class of claimants section 510(b) was designed to subordinate. Second, ERISA claims are not based on the company's status as an issuer of securities, or on the participant's status as an investor in company stock, but rather on the company's distinct status as a plan fiduciary charged with a unique obligation to safeguard the interests of the pension plan and its participants. Merrimac owed a fiduciary duty to the Plan and its participants not because it was the issuer of securities or because the Plan was an investor in Merrimac stock, but because it was a Plan fiduciary obligated to safeguard the Plan's interests with prudence and loyalty in conformity with ERISA. Similarly, the Plan and its participants were not ordinary equity investors that share the risk of their company's failure. Rather, the Plan and its participants are entities uniquely protected by the special duties imposed upon all plan fiduciaries by ERISA. Section 510(b) of the Bankruptcy Code does not, by its terms or intent, subordinate these ERISA-based claims to the claims of other unsecured creditors.

Indeed, most courts recognize that the text of section 510(b) – particularly the phrase "arising from" – is ambiguous. See, e.g., In re Geneva Steel Co., 281 F.3d 1173, 1179 (10th Cir. 2002); In re Telegroup, Inc., 281 F.3d 133, 138 (3d Cir. 2002). As the Third Circuit has explained: "For a claim to 'arise from the purchase or sale of a security,' there must obviously be some nexus or causal relationship between the claim and the sale of the security, but § 510(b)'s language alone provides little guidance in delineating the precise scope of the required nexus." Id. at 138.[2]

Given the textual ambiguity just described, courts have generally sought guidance from the legislative history in delineating the scope of the statutory provision. See, e.g., In re Telegroup, 281 F.3d at 138-41; In re Granite Partners, L.P., 208 B.R. 332, 336-37 (Bankr. S.D.N.Y. 1997). One revealing piece of legislative history is the Report of the Commission on Bankruptcy Laws of the

[2] In construing the term "relate to" in ERISA's preemption provision, 29 U.S.C. 1144(a), the Supreme Court has recognized that, despite its breadth, that term must be construed in light of ERISA's statutory purposes. New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co., 514 U.S. 645, 656 (1995) ("We simply must go beyond the unhelpful text and the frustrating difficulty of defining its key term, and look instead to the objectives of the ERISA statute as a guide to the scope of the state law that Congress understood would survive."). So too here: the phrase "arising from the purchase or sale of . . . a security" in section 510(b) of the Bankruptcy Code must be read, not in the broadest possible sense to encompass every claim that touches on securities, but in the sense that best gives effect to the more limited statutory purpose to subordinate claims arising from a claimant's status as a shareholder, given the assumption of risk attendant to that status.

United States, H.R. Doc. No. 93-137, pts. I & II (1973) (Commission Report), reprinted in Collier on Bankruptcy app. B, pt. 4(c) (Alan N. Resnick et al. eds., 15th ed. rev. 2004), which contained proposed language very similar to section 510(b)'s final language. See Granite Partners, 208 B.R. at 336 n.8. According to the accompanying explanation, the proposed provision was "intended to reach claims by holders of the debtor's securities that were based on 'federal and state securities legislation, rules pursuant thereto, and similar laws,' but would not affect any other claim (e.g., a wage claim) which the investor also held." Id. (quoting Commission Report, pt. II, at 116, reprinted in Collier, supra, app. B, pt. 4(c) at 4-684). If the same intent is attributed to the Congress that later adopted the same statutory language, it is strong evidence that section 510(b) was not designed to apply to ERISA claims, particularly benefit claims, which are similar to wage claims. See Horn v. McQueen, 215 F. Supp. 2d 867, 879 (W.D. Ky. 2002); Reich v. Valley Nat'l Bank, 837 F. Supp. 1259, 1286-87 (S.D.N.Y. 1993); see also 11 U.S.C. § 507(a)(3), (4) (giving wages and employee benefits similar priority in bankruptcy).

The key report that accompanies the enacted provision reveals the same intent – to ensure that shareholders with securities law claims would not be treated in the same manner in bankruptcy as general unsecured creditors. See H.R. Rep. No. 95-595, at 194 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6154. In

determining that such claims should be subordinated, Congress relied heavily on a law review article written by Professors John J. Slain and Homer Kripke, The Interface between Securities Regulation and Bankruptcy – Allocating the Risk of Illegal Securities Issuance between Securityholders and the Issuer's Creditors, 48 N.Y.U. L. Rev. 261 (1973) (Slain & Kripke). See H.R. Rep. No. 95-595, at 194-96, reprinted in 1978 U.S.C.C.A.N. at 6154-56; In re Betacom of Phoenix, Inc., 240 F.3d 823, 829 (9th Cir. 2001). As the title of their article indicates, the law professors focused their attention on allocating losses arising from the illegal issuance of securities, and argued that shareholders, rather than general creditors, should bear the risk of illegal issuance of securities as well as the risk of enterprise insolvency. Slain & Kripke, supra, at 286-88. In their view, both risks are voluntarily assumed by shareholders, who hope to obtain profits through an equity investment, and neither is assumed by creditors, who assert a fixed dollar claim and rely on the equity cushion provided by the shareholders in case of bankruptcy. Id. The bill enacted by Congress "generally adopt[ed] the Slain/Kripke position." H.R. Rep. No. 95-595, at 196, reprinted in 1978 U.S.C.C.A.N. at 6156; see also Geneva Steel, 281 F.3d at 1176 (describing Slain & Kripke argument and legislative history); Telegroup, 281 F.3d at 140-41 (same).

The Slain & Kripke rationale for subordinating shareholder claims does not apply to ERISA claims. Under the strict legal regime of fiduciary duties imposed

by ERISA, a participant or beneficiary in an ERISA plan does not assume the type or degree of risk borne by a typical equity investor in the securities market. ERISA is designed to minimize the risk to retirement savings by interposing fiduciaries subject to strict duties of prudence and loyalty between plan participants and the market. See 29 U.S.C. § 1001(b) (ERISA purposes); 29 U.S.C. 1104(a)(1)(A)-(D), 1106 (ERISA fiduciary duties); Donovan v. Bierwirth, 680 F.2d 263, 272 n.8 (2d Cir. 1982) (ERISA imposes upon plan fiduciaries duties of prudence and loyalty that are the "highest known to the law"). The interests of ERISA participants in their plans, including ESOPs, are thus protected by a detailed legal regime that has no equivalent in the laws protecting ordinary shareholders. See Moench v. Robertson, 62 F.3d 553, 568-70 (3d Cir. 1995) (discussing fiduciary duties of ESOP fiduciaries). Consequently, the underlying rationale for section 510(b) – to make equity investors bear the risks of corporate insolvency – does not apply when ERISA participants challenge investment decisions made by their fiduciaries.

Nor do ERISA claims themselves resemble the type of securities law claims that Congress addressed in section 510(b). ERISA claims do not "arise from" any breach of a company's duties under the securities laws, such as securities fraud or violation of insider trading rules. The Secretary and plan participants do not bring ERISA claims to vindicate their interests as shareholders, but rather to vindicate

the plan's rights to stringent standards of fiduciary conduct. And the injuries they allege stem from the misconduct of the company in its capacity as a plan fiduciary, not in its capacity as a corporate issuer or market participant.[3]

Thus, courts recognize that the duties corporations owe to all their shareholders, including plans or plan participants, are distinct from the ERISA duties that corporations owe to plans and plan participants when they act as fiduciaries. "The state law and ERISA duties are parallel but independent: as director, the individual owes a duty, defined by state law, to the corporation's shareholders, including the plan; as fiduciary, the individual owes a duty, defined by ERISA, to the plan and its beneficiaries." Sommers Drug Stores Co. Employee Profit Sharing Trust v. Corrigan Enters., Inc., 793 F.2d 1456, 1468 (5th Cir. 1986); accord Abraham v. Norcal Waste Sys., Inc., 265 F.3d 811, 822 (9th Cir. 2001); In re WorldCom, Inc., 263 F. Supp. 2d 745, 765 (S.D.N.Y. 2003) (recognizing the existence of separate but "overlapping duties" under ERISA and the securities laws); In re Enron Corp. Sec., Derivative & "ERISA" Litig., 284 F. Supp. 2d 511, 565-66 (S.D. Tex. 2003) (similar); Rankin v. Rots, 278 F. Supp. 2d 853, 877-78 (E.D. Mich. 2003) (similar); see also Stein v. Smith, 270 F. Supp. 2d 157, 167 (D. Mass. 2003) (similar).

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[3] This is not to say that a plan or its participants may never bring securities law claims in their capacity as investors. Those claims – like other shareholder claims but unlike ERISA claims – could be subject to mandatory subordination under section 510(b).

Both the decisions below noted that, under the "federal savings clause" to ERISA preemption, 29 U.S.C. § 1144(d), ERISA does not trump other federal laws, such as the Bankruptcy Code. App. 176, 374. But those comments fail to address the underlying question, which is whether section 510(b) applies to ERISA claims at all.[4] They also ignore the fundamental canon of statutory interpretation that, "[w]hen two statutes are capable of co-existence, it is the duty of the courts, absent a clearly expressed congressional intention to the contrary, to regard each as effective." FCC v. NextWave Personal Communications, Inc., 537 U.S. 293, 304 (2003) (Bankruptcy Code and Communications Act of 1934); see also Patterson v. Shumate, 504 U.S. 753 (1992) (ERISA and Bankruptcy Code); Guidry v. Sheet Metal Workers Nat'l Pension Fund, 493 U.S. 365 (1990) (ERISA and Labor Management Reporting and Disclosure Act).

Here, as in Patterson, there is no conflict between ERISA and the Bankruptcy Code. Section 510(b) is ambiguous in the context of ERISA claims involving company stock. Analysis of the legislative history and purposes of both

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[4] The bankruptcy court also relied in part on In re Lenco, Inc., 116 B.R. 141 (Bankr. E.D. Mo. 1990), in which a bankruptcy court subordinated an ERISA fiduciary breach claim under section 510(b). For the reasons already explained, we think that Lenco was wrongly decided. It is also distinguishable from this case on its facts, as the fiduciary breach at issue concerned the actual sale and purchase of securities by an ESOP. But see In re Drexel Burnham Lambert Group, Inc., 138 B.R. 717, 718 (Bankr. S.D.N.Y. 1992) (questioning whether section 510(b) overrides the provisions of ERISA that protect employee benefit plans from fiduciary misconduct).

statutes makes clear that fiduciary breach and benefit claims involving employee benefit plans are not the type of claims that section 510(b) was designed to encompass. Thus, this Court should preserve the effectiveness and intent of both section 510(b) and ERISA by holding that mandatory subordination does not apply to ERISA claims.

C. ERISA claims are not claims for damages within the meaning of section 510(b) of the Bankruptcy Code

Harrison's ERISA claims also fall outside the scope of section 510(b) of the Bankruptcy Code because they do not seek "damages" as that term is commonly understood. 11 U.S.C. § 510(b).[5] "The damages remedy was historically a legal remedy," which provides a jury trial as a matter of right under the Seventh Amendment. Dan B. Dobbs, Law of Remedies § 1.2, at 9 (2d ed. 1993). See also Aetna Health Inc. v. Davila, 124 S. Ct. 2488, 2499 (2004); OceanSpray Cranberries, Inc. v. PepsiCo, Inc., 160 F.3d 58, 61 (1st Cir. 1998) (describing damages as a legal remedy). Unlike claims for securities fraud, which seek damages and are tried to a jury, see, e.g., Wharf (Holdings) Ltd. v. United Int'l Holdings, Inc., 532 U.S. 588 (2001), ERISA claims are equitable in nature, are not tried to a jury, and do not seek damages as that term is used in section 510(b).

[5] Neither the Bankruptcy Code nor its legislative history contains a definition or explanation of the term "damages." In re Blondheim Real Estate, Inc., 91 B.R. 639, 640 (Bankr. D.N.H. 1988).

In his complaint, Harrison makes a claim for plan benefits under ERISA section 502(a)(1)(B), 29 U.S.C. § 1132(a)(1)(B), and claims for relief under ERISA sections 502(a)(2) and 502(a)(3), 29 U.S.C. § 1132(a)(2), (3), to remedy breaches of fiduciary duty. This Court has held that damages are not a permissible remedy in an ERISA benefit claim; the claimant may seek only the benefits provided by the plan. Turner v. Fallon Cmty. Health Plan, Inc., 127 F.3d 196, 198-99 (1st Cir. 1997); see also Massachusetts Mut. Life Ins. Co. v. Russell, 473 U.S. 134 (1985) (ERISA plan participant may not seek extracontractual damages for improper processing of benefit claim under 29 U.S.C. § 1109(a)). Moreover, most courts have held that ERISA benefit claims are equitable in nature and do not entitle parties to a jury trial. See, e.g., Turner v. CF&I Steel Corp., 770 F.2d 43, 46-47 (3d Cir. 1985); Berry v. Ciba-Geigy Corp., 761 F.2d 1003, 1006-07 (4th Cir. 1985); Calamia v. Spivey, 632 F.2d 1235, 1237 (5th Cir. 1980); Wardle v. Central States, Southeast & Southwest Areas Pension Fund, 627 F.2d 820, 829-30 (7th Cir. 1980); see also Recupero v. New England Tel. & Tel. Co., 118 F.3d 820, 831-32 (1st Cir. 1997) (noting, in ERISA benefit case, that "historically, juries have had no part in judicial review of out-of-court decisions" such as typical benefit claims). Accordingly, Harrison's claim for benefits is not a claim for "damages."

Nor does he seek damages to remedy the alleged fiduciary breaches. As an initial matter, we question whether Harrison's claim under section 502(a)(2), 29

U.S.C. 1132(a)(2), is viable because it seeks no identifiable relief on behalf of the Plan, as that provision requires. Russell, 473 U.S. at 140. However, by claiming that MPC failed to provide adequate security for his note, Harrison does state a claim for breach of fiduciary duty under section 502(a)(3), 29 U.S.C. 1132(a)(3), which allows an individual participant to recover "appropriate equitable relief" to remedy a fiduciary breach even when the plan has not been harmed. Varity Corp. v. Howe, 516 U.S. 489, 507-15 (1996). Because section 502(a)(3) by its terms authorizes only "equitable relief," which was historically distinct from damages, Harrison's fiduciary breach claim cannot possibly be said to seek "damages" within the meaning of section 510(b) of the Bankruptcy Code.[6]

Most courts have recognized the inherently equitable nature of ERISA claims for breach of fiduciary duty by denying requests for jury trials. See, e.g., Borst v. Chevron Corp., 36 F.3d 1308, 1323-24 (5th Cir. 1994) (no jury trial on fiduciary breach claim); Broadnax Mills, Inc. v. Blue Cross & Blue Shield, 876 F. Supp. 809, 816 (E.D. Va. 1995) (collecting cases); but see Bona v. Barasch, No. 01 Civ. 2289, 2003 WL 1395932, at *35 (S.D.N.Y. Mar. 20, 2003) (under Great-West, relief that plaintiffs sought under section 502(a)(2), losses to the plan, was

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[6] ERISA was based in large part on the law of trusts, Firestone Tire & Rubber Co. v. Bruch, 489 U.S. 101, 110 (1989), and trust relationships "are, and have been since they were first enforced, within the peculiar province of courts of equity." III Austin W. Scott & William W. Fratcher, The Law of Trusts § 197, at 188 (4th ed. 1988).

legal relief that entitled them to jury trial). Indeed, the equitable character of ERISA remedies is now so well established that most litigants do not even pursue jury trials. See Dudley Supermarket, Inc. v. Transamerica Life Ins. & Annuity Co., 302 F.3d 1, 2-3 & n. 3 (1st Cir. 2002) (noting that appellants had not appealed "the district court's ruling that there is no right to trial by jury for actions alleging breach of fiduciary duty under ERISA"). This Court has also denied a request for jury trial in a corporate fiduciary breach case, explaining that "[a]ctions for breach of fiduciary duty, historically speaking, are almost uniformly actions 'in equity' – carrying with them no right to trial by jury." In re Evangelist, 760 F.2d 27, 29 (1st Cir. 1985) (Breyer, J.). The same principle applies to actions for breach of fiduciary duty under ERISA. Such actions do not seek legal relief, do not carry a right to a jury trial, and thus do not seek "damages" within the meaning of section 510(b) of the Bankruptcy Code.

II. HARRISON'S CLAIMS ARE NOT SUBJECT TO EQUITABLE SUBORDINATION UNDER THE BANKRUPTCY CODE

Section 510(c) (1) of the Bankruptcy Code provides that a bankruptcy court "may . . . under principles of equitable subordination, subordinate for purposes of distribution all or part of an allowed claim to all or part of another allowed claim or all or part of an allowed interest to all or part of another allowed interest." 11 U.S.C. § 510(c)(1). Unlike section 510(b), which requires subordination of a narrow class of claims, section 510(c) permits a bankruptcy court, sitting as a court

of equity, to subordinate virtually any claim when it is equitable to do so based on the facts of a particular case. Section 510(c), however, does not permit subordination of any general category of claims. Therefore, the courts below erred by subordinating Harrison's claims on a categorical basis without any inequitable conduct on his part.

The Supreme Court has held that the Bankruptcy Code does not permit the categorical subordination of any class of claims under section 510(c), because to do so would be "in derogation of Congress's scheme of priorities." United States v. Noland, 517 U.S. 535, 536 (1996). As the Court explained, "the adoption in § 510(c) of 'principles of equitable subordination' permits a court to make exceptions to a general rule when justified by particular facts." Id. at 540. It does not permit bankruptcy courts to make decisions "at the level of policy choice at which Congress itself operated in drafting the Code." Id. at 543.

In a companion case, United States v. Reorganized CF&I Fabricators of Utah, Inc., 518 U.S. 213 (1996), the Court made clear that the principles articulated in Noland were not limited to "subordination from a higher priority class to the residual category of general unsecured creditors at the end of the line." Id. at 229. The same principles bar the subordination of "a disfavored subgroup within the residual category" – as occurred in CF&I and this case – because "categorical reordering of priorities that takes place at the legislative level of consideration is

beyond the scope of judicial authority to order equitable subordination under § 510(c)." Id.[7]

Therefore, the decision of the lower courts in this case to subordinate Harrison's claims because they fall in the disfavored category of "stock redemption claims" is directly contrary to the interpretation of section 510(c) contained in Noland and CF&I. The older First Circuit cases on which the lower courts and appellee rely to support categorical subordination of stock redemption claims, Keith v. Kilmer, 261 F. 733 (1st Cir. 1920), and Matthews Bros. v. Pullen, 268 F. 827 (1st Cir. 1920), cannot be binding precedent now (MPC Br. 12), because they were decided long before the enactment of section 510(c) in 1978 and its authoritative construction in Noland and CF&I. Similarly, most of the other case law that arguably supports the result below (see MPC Br. 12-18) also predates Noland and CF&I, and later decisions of the lower courts, such as In re Main Street Brewing Co., 210 B.R. 662 (Bankr. D. Mass. 1997), do not adequately address the rationale of Noland.

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[7] In this appeal, Merrimac makes the same argument that the Supreme Court rejected in CF&I – that Noland prohibits only subordination of "claims that Congress specifically chose to treat as priority claims." MPC Br. 20-21. But even if that were true – and it is not – the Bankruptcy Code does give statutory priority to some employee benefit claims. For example, fringe benefits earned by employees for postpetition services are entitled to administrative expense priority. In re Hechinger Inv. Co., 298 F.3d 219 (3d Cir. 2002). And a certain amount of fringe benefits earned within 180 days prepetition is entitled to priority under 11 U.S.C. § 507(a)(4).

Nor was the district court correct in stating that "a corporation acquires nothing of value when it purchases its own stock" from a former employee who participated in an ESOP. App. 370. ERISA benefits, like all fringe benefits, are part of an employee's total compensation package, and are paid in exchange for the employee's labor on behalf of his employer over the course of his career. See Horn v. McQueen, 215 F. Supp. 2d at 879; Reich v. Hall Holding Co., 990 F. Supp. 955, 960-61 (N.D. Ohio 1998), aff'd, 285 F.3d 415 (6th Cir. 2002); Reich v. Valley Nat'l Bank, 837 F. Supp. at 1286-87. Thus, Harrison had already earned his benefits when he exercised his put option to convert his stock to retirement income. Accordingly, even if this Court continues to subordinate some stock redemption claims under section 510(c), claims based on put options mandated by the Internal Revenue Code and ERISA regulations (see infra, p. 26 n.8) should not be among them.

Although the Supreme Court did not decide in Noland "whether a bankruptcy court must always find creditor misconduct before a claim may be equitably subordinated," 517 U.S. at 543, there is considerable support for that position in the legislative history and case law, including decisions of this Court. The Senate Report describing the provision that became section 510(c) explains that "any subordination ordered under this provision must be based on principles of equitable subordination. These principles are defined by case law, and have

generally indicated that a claim may normally be subordinated only if its holder is guilty of misconduct." S. Rep. No. 95-989, at 74 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5860 (emphasis added).

In Noland itself, the Supreme Court cited with approval an "influential opinion" of the Fifth Circuit, In re Mobile Steel Co., 563 F.2d 692 (1977), which listed three conditions for equitable subordination: (1) the claimant must have engaged in "some type of inequitable conduct," (2) the misconduct must have "resulted in injury to the creditors of the bankrupt or conferred an unfair advantage on the claimant," and (3) subordination must "not be inconsistent with the provisions of the Bankruptcy Act." Noland, 517 U.S. at 538-39 (quoting Mobile Steel, 563 F.2d at 700). This Court has adopted the Mobile Steel test for equitable subordination. In re 604 Columbus Ave. Realty Trust, 968 F.2d 1332, 1353 (1st Cir. 1992); In re Giorgio, 862 F.2d 933, 938-39 (1st Cir. 1988) (Breyer, J.). Indeed, even before Noland, this Court had adopted the principles that equitable subordination requires a case-by-case determination, Giorgio, 862 F.2d at 938, and a showing of wrongdoing by the subordinated creditor. Columbus Ave., 968 F.2d at 1353.

Under these principles, the decision to subordinate Harrison's claims under section 510(c) must be reversed. The courts below did not "examine the equities of [his] particular claim," Giorgio, 862 F.2d at 938, or find any "wrongdo[ing]" on his

part. Columbus Ave., 968 F.2d at 1353. Instead, they applied an obsolete doctrine of categorical subordination of stock redemption claims, which this Court should now reject.[8]

[8] There is no suggestion that Harrison engaged in any inequitable conduct that would justify subordination of his claims under section 510(c). Courts generally define "inequitable conduct" within the meaning of section 510(c) to include "(1) fraud, illegality, breach of fiduciary duties; (2) undercapitalization; and (3) claimant's use of the debtor as a mere instrumentality or alter ego." In re Lifschultz Fast Freight, 132 F.3d 339, 344-45 (7th Cir. 1997) (citations omitted). In this case, all Harrison did was to exercise a put option included in his plan as required by the Internal Revenue Code, 26 U.S.C. § 409(h)(1)(B), and Labor Department regulations, 29 C.F.R. § 2550.408b-3(l)(4), to enable him to cash out his stock upon retirement. See generally S. Rep. No. 95-1263, at 79, 83 (1978), reprinted in 1978 U.S.C.C.A.N. 6761, 6842, 6846. Thus, while there may be some cases in which equitable subordination of ERISA claims is appropriate, that determination would have to be made on a case-by-case basis, and no one contends that it is appropriate here.

CONCLUSION

The judgment of the district court subordinating Harrison's ERISA claims under sections 510(b) and 510(c) of the Bankruptcy Code should be reversed.

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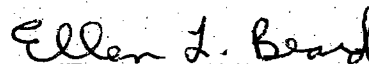

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(s) Ellen L. Beard

Attorney for Secretary of Labor, Elaine L. Chao, as amicus curiae

Dated: May 11, 2005

CERTIFICATE OF SERVICE

I hereby certify that on May 11, 2005, two paper copies of the amicus brief for the Secretary of Labor, Elaine L. Chao, were served using Federal Express, postage prepaid, upon the following counsel of record:

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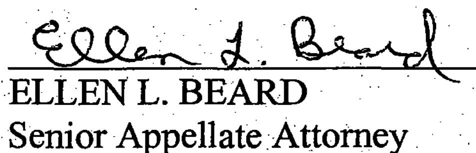

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ADDENDUM A

UNITED STATES DISTRICT COURT
DISTRICT OF MASSACHUSETTS

ALAN R. EGGERT and RALPH HARRISON, **Plaintiffs,** v. THE MERRIMAC PAPER COMPANY, INC. LEVERAGED EMPLOYEE STOCK OWNERSHIP PLAN AND TRUST (the "ESOP"), MERRIMAC PAPER CO., INC., in its corporate capacity and as Sponsor of the ESOP, and GERARD J. GRIFFIN JR., BREWSTER STETSON, JAMES MORIARTY, and JOHN T. LEAHY, as they are or were Administrators and/or Trustees of the ESOP, **Defendants.**	)	Civil Action No. 03-10048-MLW

THIRD AMENDED COMPLAINT AND DEMAND FOR JURY TRIAL

INTRODUCTION

1. Plaintiffs worked for Defendant Merrimac Paper Co., Inc. ("MPC") for 25 and 36 years respectively, before agreeing to separate from service on different dates in 2000. At the time of their separations, Plaintiffs participated in the ERISA-protected Merrimac Paper Company, Inc. Leveraged Employee Stock Ownership Plan and Trust (the "ESOP"), and had attained fully vested interests in their ESOP accounts, each of which was credited with a substantial quantity of MPC's common stock. Under the terms of the ESOP, Plaintiffs sold (i.e., "put") their common stock back to the ESOP, and in return received (*inter alia*) promissory notes from MPC. However, the promissory notes have not been honored and the Plaintiffs have not yet received the ESOP benefits to which they are entitled, thus necessitating this lawsuit.

2. Plaintiffs bring this action under ERISA to recover vested benefits due to them under the ESOP, and for relief based upon certain Defendants' fiduciary duty breaches. Plaintiff

Alan Eggert also includes state law claims for breach of contract against Defendant MPC, to enforce the Promissory Note issued to him. Plaintiff Ralph Harrison earlier commenced a separate such claim against Defendant MPC in Massachusetts Superior Court, which has since been removed to this Court.

PARTIES

3. Plaintiff Alan R. Eggert is an individual who resides at 109 Sugar Creek Lane, Greer, South Carolina.

4. Plaintiff Ralph Harrison is an individual who resides at 81 Elm Street, Andover, Massachusetts.

5. Defendant Merrimac Paper Company Leveraged Employee Stock Ownership Plan and Trust (the "ESOP") is, and at all time relevant hereto was, intended to qualify as (i) a stock bonus plan under Section 401(a) of the Internal Revenue Code of 1986, as amended (the "Code"), (ii) an employee pension benefit plan within the meaning of Section 3(2) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), and (iii) an employee stock ownership plan within the meaning of Section 4975(e)(7) of the Code, and Section 407(d)(6) of ERISA. The ESOP has a principal place of business c/o Merrimac Paper Co., Inc., 9 South Canal Street, Lawrence, Essex County, Massachusetts.

6. Defendant Merrimac Paper Co., Inc. ("MPC") is a duly organized Delaware corporation with a principal place of business at 9 South Canal Street, Lawrence, Essex County, Massachusetts 01842. At relevant times, MPC has operated paper product-related manufacturing facilities in Lawrence, Holyoke and Pepperell, Massachusetts.

7. Defendant Gerard J. Griffin Jr., is an individual who resides at 4 Orchard

Crossing, Andover, Massachusetts.

8. Defendant Brewster Stetson is an individual who resides at 23 Garrison Road, Wellesley, Massachusetts.

9. Defendant James Moriarty is an individual who resides at 9 Bean Porridge Hill Road, Westminster, Massachusetts.

10. Defendant John T. Leahy is an individual who resides at Thrasher Hill Road, Worthington, Massachusetts.

JURISDICTION

11. This Court has subject matter jurisdiction under 28 U.S.C. § 1331, as this case is based upon one or more causes of action arising under the laws of the United States, including under Sections 502(a)(1)(B), 502(a)(2) and 502(a)(3) of ERISA, 29 U.S.C. § 1132(a)(1)(B), (a)(2) and (a)(3).

12. This District is an appropriate venue for this case pursuant to 28 U.S.C. § 1391(b) and ERISA Section 502(e)(2), 29 U.S.C. § 1132(e)(2), as Defendants MPC, Griffin, Stetson, Moriarty and Leahy reside, and Defendant ESOP is administered, in Eastern Massachusetts.

FACTS

The ESOP

13. Defendant ESOP was established and sponsored by Defendant MPC, and it became effective on January 1, 1985. See **Exh. A** hereto (the "Plan Document").[1]

14. The ESOP is an employee pension benefit plan within the meaning of Section

[1] The ESOP was recently terminated by MCP, effective as of August 1, 2002. The termination bears no consequence for Plaintiffs' ERISA claims in this case, which are brought to enforce vested rights perfected years prior to the termination of the ESOP.

3(2) of ERISA, 29 U.S.C. § 1002(2).

15. Under the ESOP, *inter alia*: (i) normal retirement age is 65 years; (ii) all benefits shall be distributed either in whole common stock of Defendant MPC, or in cash, or in a combination thereof; (iii) all benefits shall be payable in a lump sum; (iv) upon termination of employment of a participant for any reason other than death, permanent disability or attaining normal retirement age, the participant's vested account balance shall be payable on the 60th day following the end of the calendar year in which such employment termination occurs; (v) participants shall have the right to sell, or "put," shares distributed to him or her back to the ESOP or to MPC (as the ESOP Sponsor); (vi) in the event that participants elect to sell or "put" his or her shares, the ESOP or MPC may elect to pay for the shares in a lump sum or in 5 (or fewer) equal annual installments – provided, however, that if installment payments are elected, a fair interest rate is paid and adequate security is provided. See **Exh. A**.

16. At all relevant times and currently, Plaintiffs are vested Participants in the ESOP. In their capacities as such, Plaintiffs have at different times received Summary Plan Description documents describing the ESOP. See, e.g, **Exh. B** hereto (the "SPD"). Unlike the underlying Plan Document, the SPD failed to mention (as it should have) the requirement for "adequate security" to be provided when shares are "put" and installment payments (rather than a lump sum) are promised. Compare **Exh. A** at § 10.04(a) with **Exh. B**.

17. At all relevant times and currently, Defendants have served as fiduciaries under the ESOP. See also ¶¶ 18-24, *infra*.

18. At all relevant times and currently, MPC is the sponsor of the ESOP.

19. At all relevant times and currently, the administrator of the ESOP is the ESOP

committee appointed pursuant to the ESOP terms to administer the ESOP (the "ESOP Committee" or "ESOP Administrator").

20. At all relevant times and currently, all ESOP assets are held in trust by the ESOP trustees designated by MPC's board of directors in accordance with the terms of the ESOP (the "ESOP Trustees").

21. From or around August 2002 to the present, Defendant Leahy is the sole ESOP Trustee and ESOP Committee member.

22. From or around January 1, 2002 to August 2002, Defendant Griffin was the sole ESOP Trustee and ESOP Committee member.

23. From or around January 1, 2001 to December 31, 2001, Defendants Griffin and Stetson together served as the exclusive ESOP Trustees and ESOP Committee members.

24. From or around April 1998 to December 30, 2000, Defendants Griffin, Stetson and Moriarty together served as the exclusive ESOP Trustees and ESOP Committee members.

The Harrison Note

25. In December 1999, Plaintiff Ralph Harrison, a 36-year employee of MPC, agreed to separate from service with MPC, and applied for a distribution of his ESOP benefit, including by electing to sell, or "put," his vested common stock back to MPC or the ESOP under the terms of the ESOP. See Letter Agreement, **Exh. C.** hereto.

26. Based upon an independent business valuation appraisal report prepared at the behest and on behalf of MPC and/or the ESOP, Mr. Harrison's ESOP account balance was valued at $1,116,200 at the time he applied for a distribution of his ESOP benefit.

27. In July 2000, Mr. Harrison exercised his put right under the ESOP with respect to

the MPC shares allocated to his ESOP account, and in return received a promissory note which promised to pay Mr. Harrison $916,300 plus interest at the rate of 8.50% per annum in three annual installments. See **Exh. D** hereto (the "Harrison Note") To complete the stock repurchase, Mr. Harrison was separately paid $200,000.

28. An initial installment under the Harrison Note was paid to Mr. Harrison on January 12, 2001, but the second installment of $305,434 plus accrued interest was not paid as required on July 19, 2002, and – despite timely demands – no further payment has been made.

29. Under the terms of the Harrison Note, such non-payment constitutes a default, and all principal and interest is now due and owing thereunder, plus costs of collection. See **Exh. D**.

30. However, the Harrison Note provided no security to protect Mr. Harrison in the event of such default. Id.

31. Solely to enforce the contractual obligations under the Harrison Note, but not any obligations under ERISA, Mr. Harrison has commenced an action against Defendant MPC in Massachusetts Superior Court: Harrison v. Merrimac Paper Co., Inc., C.A. No. 02-1687-B (Essex Super. Ct.). That case has since been removed to this Court.

The Eggert Note

32. In November 2000, Mr. Eggert agreed to separate from service from MPC after 25 years of employment.

33. On December 7, 2000, in connection with his separation from service, Mr. Eggert applied for a distribution of his ESOP benefit, and in connection therewith exercised his right under the ESOP to sell, or "put," his vested common stock back to MPC or the ESOP:

> "I understand that under Section 10.01 of . . . [the ESOP], I may receive a distribution from the ESOP in whole shares of the Common Stock of . . . [MPC] and that under Section 10.04 of the ESOP I have the right (the "Put") to require the Company or the ESOP to repurchase those shares. [¶] I hereby exercise the Put with respect to 850.92 Shares of the Company's Common Stock distributed to me by the ESOP. I understand that in accordance with Section 10.04(a) of the ESOP, the Company or the ESOP's Trust will, at their election, pay me a lump sum or in five or less equal annual installments for those shares at a closing withing thirty (30) days of the date of the Company's receipt of this notice."

Put Exercise, **Exh. E**.

34. Based upon an independent business valuation appraisal report prepared at the behest and on behalf of MPC and/or the ESOP at the time of Mr. Eggert's separation from service, the MPC stock credited to his ESOP account was valued at $1,555,500.

35. On or around December 29, 2000, Mr. Eggert received a promissory note signed by Defendant Griffin under which he was promised $1,555,500, plus interest at the rate of 8.50 % per annum, to be paid in five annual installments of 20% each commencing on December 29, 2001. See **Exh. F** hereto (the "Eggert Note").

36. The first installment under the Eggert Note of $443,317.50 ($311,100 principal; $132,217.50 interest) was due on December 29, 2001, but it was not paid, and – despite timely demands – no further payment has been made.

37. Under the terms of the Eggert Note, such non-payment constitutes a default, and all principal and interest is now due and owing thereunder, plus costs of collection. See **Exh. F** (if any installment is not paid when due, then all installments plus interest "shall become immediately due and payable" together with "all costs of collection . . . including reasonable attorney's fees").

38. Consequently, Mr. Eggert is currently entitled to immediate payment of

$1,819,935 plus all "costs of collection."

39. However, the Eggert Note provided no security to protect Mr. Eggert in the event of default. See **Exh. F**.

COUNT I – Unlawful Denial of Benefits Under ERISA [29 U.S.C. § 1132(a)(1)(B)]
(Plaintiffs v. Defendants)

40. Plaintiffs restate and incorporate by reference all of the allegations in Paragraphs 1-39 above as though fully set forth herein.

41. Having taken all necessary preliminary steps, Plaintiffs are legally entitled to receive payment from Defendant ESOP in the aggregate amount of $2,166,368 plus accrued interest at the rate of 8.5% since issuance of the promissory notes and all costs of collection.

42. Defendants failed to fulfill their obligation to Plaintiffs by paying them the amounts due for their stock, despite agreeing to do so, and having received valid demands by Plaintiffs in accordance with the ESOP.

43. The Harrison Note and Eggert Note did (and do) not satisfy Defendants' obligation to pay to Plaintiffs their accrued benefit under the ESOP, because, *inter alia*, (i) the Promissory Notes failed to give "adequate security" to the Plaintiffs as required under the ESOP, ERISA and the IRC, see, e.g., **Exh. A** at § 10.04(a); 29 CFR 2550.408b-3(l)(4); and 26 CFR 54.4975-7(b)(12)(4), (ii) Defendants knew at the time of issuance that they either did not intend to or could not meet the obligations under the Harrison Note and Eggert Note, and (iii) defaults under the Harrison Note and Eggert Note have in fact occurred.

44. Plaintiffs have exhausted all administrative prerequisites to judicially compel Defendants to pay their full benefit under the ESOP.

45. As a result of Defendants failure to repurchase Plaintiffs' stock under the ESOP, Plaintiffs have suffered financial and other injuries, including to their reasonable retirement plans and expectations.

46. The foregoing conduct of Defendants constitutes a violation of ERISA.

COUNT II – Breach of Duties Under ERISA [29 U.S.C. §§ 1109, 1132(a)(2), 1132(a)(3)]
(Plaintiffs v. All Defendants)

47. Plaintiffs restate and incorporate by reference all of the allegations in Paragraphs 1-46 above as though fully set forth herein.

48. Defendants have violated their duties under ERISA, including (without limitation) the duty to act with the care, skill, prudence, and diligence of a prudent person acting in a like capacity and familiar with these matters, by (*inter alia*):

A) Failing to provide adequate security for the Promissory Notes, which have now been breached by Defendant MPC.

B) Preparing and distributing (or causing to be prepared and distributed) materially misleading information concerning the ESOP, including an SPD which failed to mention the requirement that adequate security be provided, per the express terms of the ESOP.

C) Failing to administer and operate the ESOP in accordance with its terms.

D) Failing to discharge their duties with respect to the ESOP solely in the interest of the ESOP participants, including Plaintiffs.

E) Failing to discharge their duties with respect to the EOP for the exclusive purpose of providing benefits to participants, including Plaintiffs.

49. Each Plaintiff has materially relied upon the foregoing misconduct of Defendants – including (without limitation) by relying upon the misleading and incomplete SPDs in accepting deficient promissory notes which failed to provide adequate security in violation of ERISA – to his substantial detriment.

50. As a reasonable and proximate result of the foregoing violation, harm has been done both to the ESOP and to Plaintiffs personally, in violation of ERISA.

51. Defendant MPC and the individual Defendants, Messrs. Griffin, Stetson, Moriarty and Leahy, are personally liable to reimburse Defendant ESOP for harm caused thereto as a result of their fiduciary duty breaches.

52. Plaintiffs also are entitled to such further equitable relief as may be available to enforce their rights under the ESOP, including (without limitation) adequate security for the Promissory Notes, including by awarding Plaintiffs priority over the security interests otherwise provided by Defendant MPC to its lenders following the establishment of the ESOP.

COUNT III – Breach of Duties Under ERISA [29 U.S.C. § 1109 and 1132(a)(3)]
(Plaintiffs v. Defendants Griffin, Stetson, Moriarty and Leahy)

53. Plaintiffs restate and incorporate by reference all of the allegations in Paragraphs 1-52 above as though fully set forth herein.

54. Defendants Griffin, Stetson, Moriarty and Leahy, separately or together, have violated their duties under ERISA, including (without limitation) the duty to act with the care, skill, prudence, and diligence of a prudent person acting in a like capacity and familiar with these matters, by (*inter alia*):

A) Making false and misleading representations regarding the Harrison Note and the Eggert Note.

B) On information and belief, failing to administer and operate the ESOP for the exclusive benefit of the Participants (including Plaintiffs).

C) On information and belief, engaging in prohibited transactions, including (without limitation) using ESOP assets for the benefit of Defendants (other than in their capacities as ESOP participants, and in accordance with the terms of the ESOP) or others.

D) On information and belief, engaging in self-serving transactions and self-dealing to the foreseeable detriment of ESOP participants (including Plaintiffs), including by siphoning funds out of or directing funds away from the ESOP to benefit themselves, Defendant MPC or creditors of Defendant MPC.

E) On information and belief, allowing their conflict of interest to cause harm to the ESOP and Plaintiffs personally.

55. As a reasonable and proximate result of the foregoing violation, harm has been done both to the ESOP and to Plaintiffs personally, in violation of ERISA.

56. Defendants Griffin, Stetson, Moriarty and Leahy are personally liable to reimburse the ESOP for harm caused thereto as a result fo their fiduciary duty breaches.

57. Plaintiffs also are entitled to such further equitable relief as may be available to enforce their rights under the ESOP, including (without limitation) the provision of adequate security for the promissory notes even if that means awarding Plaintiffs priority over the security interests otherwise provided by Defendant MPC to its lenders following the establishment of the ESOP, as well as statutory penalties of up to $110 per day per Plaintiff.

COUNT IV – Breach of Contract
(Plaintiff Eggert v. Defendant MPC)

58. Plaintiffs restate and incorporate by reference all of the allegations in Paragraphs 1-57 above as though fully set forth herein.

59. The Eggert Note (**Exh. F**) is supported by adequate consideration, and are otherwise duly enforceable under Massachusetts law.

60. Defendant MPC has materially breached its obligations under the Eggert Note.

61. As the reasonable, proximate and foreseeable result of MPC's breach, Mr. Eggert has suffered damages, including for foreseeable emotional distress associated with his now

insecure retirement.

62. At minimum, Mr. Eggert is due $1,819,935, plus "costs of collection . . . including reasonable attorney's fees," which already exceed $10,000.

* * *

WHEREFORE, Plaintiffs Alan R. Eggert and Ralph Harrison respectfully request this Court to:

A. Enter a judgment in favor of Plaintiffs and against Defendants on Count I, awarding Plaintiffs all benefits due them under the ESOP.

B. Enter a judgment in favor of Plaintiffs and against Defendants on Count II, ordering Defendants to reimburse the ESOP for all damages caused, and further awarding Plaintiffs such further equitable relief as may be available and just.

C. Enter a judgment in favor of Plaintiffs and against Defendants on Count III, ordering Defendants to reimburse the ESOP for all damages caused, and further awarding Plaintiffs such further equitable relief as may be available and just, as well as statutory penalties of $110 per day per Plaintiff.

D. Enter a judgment in favor of Plaintiff Eggert and against Defendant MPC on Count IV, awarding Mr. Eggert all available damages, including $1,555,500 plus interest at the rate of 8.50 % per annum since December 29, 2000, all reasonable "costs of collection . . . including reasonable attorney's fees," and just compensation for foreseeable emotional distress.

E. Enter an order awarding Plaintiffs such further and additional relief as may be available in law or equity, and which is just in this case.

DEMAND FOR JURY TRIAL

Plaintiffs hereby demand a trial by jury on all counts so triable.

PLAINTIFF ALAN R. EGGERT,
By his attorneys,

_______/s/___________________
Jeffrey B. Renton (BBO #554032)
Edward J. Denn (BBO #633020)
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Dated: September 1, 2004

PLAINTIFF RALPH HARRISON,
By his attorneys,

_______/s/_____________________
Matthew A. Caffrey (BBO #558901)
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Dated: September 1, 2004

CERTIFICATE OF SERVICE

I, Jeffrey B. Renton, hereby certify that, on this 1st day of September 2004, I caused a true and correct copy of the foregoing document to be served by first class mail upon counsel of record for Defendants.

_____/s/_______________
Jeffrey B. Renton

ADDENDUM B

United States District Court
District of Massachusetts

ALAN R. EGGERT and
RALPH HARRISON,
Plaintiffs,

v.

CIVIL ACTION NO. 03-10048-RBC[1]

THE MERRIMAC PAPER
COMPANY, INC. LEVERAGED
EMPLOYEE STOCK OWNERSHIP
PLAN AND TRUST ("the ESOP"),
MERRIMAC PAPER CO., INC.,
in its corporate capacity and
as sponsor of the ESOP,
GERARD J. GRIFFIN, JR.,
BREWSTER STETSON,
JAMES MORIARTY, and
JOHN T. LEAHY,
as they are or were
Administrators and/or
Trustees of the ESOP,
Defendants.

1

On March 27, 2003, with the parties' consent this case was referred and reassigned to the undersigned for all purposes, including trial and the entry of judgment, pursuant to 28 U.S.C. §636(c).

MEMORANDUM AND ORDER ON MOTION OF DEFENDANTS BREWSTER STETSON AND JOHN T. LEAHY TO DISMISS PLAINTIFFS' SECOND AMENDED COMPLAINT (#35), MOTION OF DEFENDANT GERARD J. GRIFFIN, JR. TO DISMISS PLAINTIFFS' SECOND AMENDED COMPLAINT (#38) AND DEFENDANT JAMES MORIARTY'S MOTION TO DISMISS PLAINTIFFS' SECOND AMENDED COMPLAINT (#39)

COLLINGS, U.S.M.J.

I. Introduction

In their Second Amended Complaint, plaintiffs Alan R. Eggert ("Eggert") and Ralph Harrison ("Harrison") assert four claims against defendants The Merrimac Paper Company, Inc. Leveraged Employee Stock Ownership Plan and Trust (the "ESOP" or the "Plan"), Merrimac Paper Co., Inc. ("MPC" or the "Company"), in its corporate capacity and as sponsor of the ESOP, and Gerard

1992) in which it was held that former employees had a colorable claim to vested benefits when they challenged a valuation made on their "put" options when the employer ceased to make contributions to the ESOP. *Werner,* 1992 WL 453355 at * 2-3. The employees had received cash, stock and the put option, and the defendants argued that this "...represented a complete distribution of vested benefits." *Id.* at * 3. That argument was rejected; the court held that the right to a particular exercise price of the "put" option price did represent an additional benefit of the Plan, writing that:

> If the put exercise price is not considered to be a 'benefit' of the plan, then participants, such as plaintiffs, would never have standing to challenge whether the employers [sic] valuation was made in good faith and based on fair market value in compliance with the Treasury Regulations.

Id. at * 3.[7]

In summary, I rule that the plaintiffs have standing to bring ERISA claims because they have shown a colorable claim to vested benefits.

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7 "Treasury Regulation § 54.4975-11(d)(5) provides that put option valuations of ESOP stock must be made in good faith and based on all relevant factors for determining fair market value of securities." *Werner,* 1992 WL 453355 at * 3.

> outright vituperation." *Correa-Martinez v. Arrillaga-Belendez,* 903 F.2d 49, 52 (1st Cir. 1990), nor to honor subjective characterizations, optimistic predictions, or problematic suppositions. *Dartmouth Review v. Dartmouth College,* 889 F.2d 13, 16 (1st Cir. 1989). "[E]mpirically 'unverifiable' conclusions, not "logically compelled, *or at least supported by the stated facts,*" deserve no defenerence. *Id.*

AVX Corp., 962 F.2d at 115 (Emphasis supplied); *see also Bartolomeo v. Liburdi*, No. 97-0624-ML, 1999 WL 143097, *4 (D.R.I., Feb. 4, 1999)("Under a Rule 12(b)(6) motion to dismiss, a claim must be supported by underlying facts and not mere conclusory allegations.").

VII. Further Discussion - Other Issues

To the extent that the defendants' motions raise other issues, the Court has determined that they are more appropriately considered on a motion for summary judgment after discovery and the development of a factual record. This applies to the question of available remedies.

VIII. Conclusion

For the reasons stated it is hereby ORDERED that the Motion of Defendant Brewster Stetson and John T. Leahy to Dismiss Plaintiffs' Second Amended Complaint (#35), the Motion of Gerard J. Griffin, Jr. to Dismiss Plaintiffs' Second Amended Complaint (#38) and Defendant James Moriarty's Motion to Dismiss Plaintiffs' Second Amended Complaint (#39) be, and the

same hereby are, ALLOWED as to Counts I and III and otherwise DENIED without prejudice to filing a motion for summary judgment after discovery.

/s/ Robert B. Collings
ROBERT B. COLLINGS
United States Magistrate Judge

March 31, 2004.