EMPLOYEE BENEFITS DEVELOPMENTS APRIL 2016

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Stock Drop Case Update: Settlement Reached in *Dudenhoeffer* Case; Dismissal of *Lehman Brothers* Lawsuit Upheld. Two recent developments in stock drop litigation are worth noting:

Dudenhoeffer Settlement. In *Fifth Third Bancorp v. Dudenhoeffer* (US Sup. Ct. 2014), the Supreme Court unanimously rejected the presumption of prudence for plans invested in employer stock. The Court ruled that plan fiduciaries are not entitled to any special presumption when investing plan assets in employer stock, even if the plan documents call for the plan to invest in employer stock. The Supreme Court's opinion in *Dudenhoeffer* also was noteworthy because is set the foundation for new pleading standards in stock drop cases. The *Dudenhoeffer* case, however, did not end with the Supreme Court's 2014 decision. In the latest development, it appears the parties are close to finalizing a settlement. In March, the plaintiffs filed a motion for preliminary approval of a settlement, and a federal district court in Ohio signed an order granting preliminary approval of the settlement. As part of the settlement, the defendants will pay $6,000,000 to be allocated to plan participants. The settlement also calls for certain structural changes to the plan (including, a freezing of the Fifth Third Stock Fund, continuing the current practice of matching contributions in cash, and improved fiduciary training).

Second Circuit Affirms Dismissal of Stock Drop Lawsuit Against Lehman Brothers. The United States Court of Appeals for the Second Circuit recently affirmed the 2015 decision of a federal district court granting Lehman Brothers' motion to dismiss a stock drop lawsuit. The Second Circuit agreed with the district court's finding that even without the presumption of prudence rejected in *Dudenhoeffer*, the plaintiff-participants' third amended complaint in a lawsuit against the defendant-fiduciaries of a Lehman Brothers employee stock ownership plan that was invested exclusively in Lehman Brothers stock "failed to plead plausibly" that the fiduciaries breached their ERISA fiduciary duties by continuing to permit investment in Lehman Brothers stock. The Second Circuit's decision is yet another in a series of recent court decision suggesting that the post-*Dudenhoeffer* pleading standards set a high bar for plaintiffs to successfully establish an ERISA breach of prudence claim in stock drop cases. In this case, it is notable that the plaintiffs were not able to use a 2008 Securities and Exchange Commission order prohibiting short-selling of Lehman Brothers securities to successfully establish the existence of a "special circumstance" that undermined the ability of plan fiduciaries to rely on a stock's market price as an "unbiased assessment of the security's value in light of all public information." *In re Lehman Brothers Securities and ERISA Litigation* (2nd Cir. 2016).

Retiree Gets to Keep Pension Overpayments. In a recent case, a federal appeals court – the United States Court of Appeals for the Sixth Circuit – held that an early retiree will get to keep pension payments that exceed the payments to which he otherwise would be entitled under the terms of the plan. In so ruling, the court applied the doctrine of equitable estoppel.

The doctrine of equitable estoppel can operate to "estop" the fiduciaries of an ERISA plan, in this case a pension plan, from enforcing the terms of the plan where the following elements are established:

- a plan representative provides incorrect information, in writing, about a participant's benefit (e.g., a pension statement reflecting an inflated monthly pension benefit);
- the plan representative is aware of the true facts (or should be), and knows that the participant is likely to rely and act upon that information in making an important decision about his benefits (e.g., the plan administrator knows the participant is contemplating early retirement);
- the participant justifiably relies on the information provided (e.g., the benefit calculations are too complex for the participant to calculate himself); and
- the participant suffers a detriment as a result of the incorrect benefit information (e.g., the participant decides to retire early based on the overstated retirement income he or she was promised).

Even where all of these elements are satisfied, the doctrine of equitable estoppel is applied only in "extraordinary circumstances," which some courts have described as conduct on the part of the plan's representatives that is tantamount to fraud. The court in this case held that all of the elements cited above had been met and, most importantly, that extraordinary circumstances existed because the incorrect benefit communication was the result of *gross negligence* on the part of the plan's representatives. The court found that the retiree specifically and repeatedly asked whether the calculations were correct, and was repeatedly assured that the calculations were correct.

Employers should always exercise reasonable care when communicating about benefit entitlements. Special care should be taken in circumstances involving early retirement incentive programs. In virtually all courts throughout the country, an honest mistake in calculating benefits (i.e., ordinary negligence) is not the type of negligence that would trigger a successful equitable estoppel claim. The exercise of reasonable care should ensure that the plan will not be bound into benefit payments that it does not, by its terms, provide. Under a recent Supreme Court decision, it is highly unlikely that pension plans will be able to recover overpayments, except through a carefully crafted provision that allows recoupment via reduction of future payments. Failing to exercise reasonable care in providing benefit statements could jeopardize a plan's ability to enforce its offset provision. *Paul v. Detroit Edison Company & Michigan Consolidated Gas Company Pension Plan* (6th Cir. 2016)

Retiree's Estate Does Not Get Pension Overpayment. In contrast to the court's decision discussed in the previous article, in this case, the United States Court of Appeals for the Sixth Circuit held that a retiree's estate is not entitled to an erroneous amount promised to the retiree prior to her death. Here, the retirement committee offered to cash out the retiree's pension benefit in a single lump sum payment of $230,361.49. The retiree elected to accept the cash out opportunity. However, before payment was made, the committee informed her of the miscalculation and that, in fact, her lump sum benefit would be $38,840.34. The retiree died within a month of being informed of the benefit miscalculation. The retiree's daughter then sued the committee for the larger amount on behalf of her mother's estate claiming a wrongful denial of benefits, breach of fiduciary duty, and equitable estoppel. The circuit court ruled in favor of the retirement committee and affirmed the district court's grant of summary judgment to the committee related to all claims. With regard to the equitable estoppel claim, the court noted that the terms of the plan were unambiguous, and that the committee's miscalculation did not detrimentally induce the retiree into making a decision she would not have otherwise made. *Donati v. Ford Motor Co.* (6th Cir. 2016)

District Court Holds Private Equity Funds Jointly and Severally Liable for Withdrawal Liability. In our August 2013 Newsletter, we discussed the United States Court of Appeals for the First Circuit's holding in *Sun Capital Partners III, LP, et al. v. New England Teamsters and Trucking Industry Pension Fund* that Sun Fund IV, a private equity fund, was considered a trade or business for purposes of potential withdrawal liability to a multiemployer pension fund. As part of its decision, the First Circuit remanded to the district court the issues of whether (i) Sun Fund III also constituted a trade or business, and (ii) whether Sun Funds III and IV were under common control with Scott Brass, Inc. ("SBI"), the former contributing employer to the pension fund.

On remand, the District Court for Massachusetts held that Sun Fund III constituted a trade or business, and that Sun Funds III and IV had formed a de facto partnership that itself was a trade or business under common control with SBI. As a result, Sun Funds III and IV were jointly and severally liable for withdrawal liability.

<u>ERISA Controlled Group Liability</u>

Under ERISA, all members of a contributing employer's controlled group are jointly and severally liable for withdrawal liability arising from the contributing employer's withdrawal from a multiemployer pension fund. For purposes of determining whether two or more trades or businesses are members of the same controlled group, PBGC regulations cross-reference the Internal Revenue Code ("Code"). Relevant to the *Sun Capital* case, the Code provides that a parent-subsidiary controlled group exists where a chain of trades or businesses are connected through a controlling interest with a common parent organization. A controlling interest is defined to mean an ownership interest of at least 80%.

<u>Summary of Facts</u>

Sun Fund III and Sun Fund IV were private equity funds formed by private equity firm Sun Capital Advisors, Inc. ("SCAI"). Sun Fund III and Sun Fund IV indirectly owned 30% and 70% of SBI, respectively. Through SCAI affiliates, Sun Fund III and Sun Fund IV actively participated in the management of SBI, and two SCAI employees were appointed to the three member SBI board. The partnership agreements for the two Sun Funds provided for a management fee offset in cases where a portfolio company, such as SBI, paid management fees to an SCAI affiliated entity.

SBI was obligated to contribute to the pension fund. However, as a result of SBI ceasing to make contributions to the pension fund in connection with its filing for bankruptcy, SBI withdrew from the pension fund. The pension fund then pursued withdrawal liability against the two Sun Funds.

The District Court's Decision

Applying the "investment plus" standard adopted by the First Circuit, the district court held that the Sun Funds were more than merely passive investors and, therefore, trades or businesses. In particular, through the actions of SCAI affiliates, the Sun Funds were actively involved in the management and operation of SBI, and the management fee offset and other fee offsets the Sun Funds received (or were entitled to receive under the respective partnership agreements) represented economic benefits an ordinary passive investor would not receive.

On the issue of common control, the district court ignored the corporate formalities followed by the Sun Funds and the parties' express intent, and held that the Sun Funds had formed a de facto general partnership. In particular the district court focused on the joint activity undertaken by the two Sun Funds in deciding to coinvest and their conscious decision to split their ownership stakes 70/30.

The district court finally concluded that the de facto partnership itself was a trade or business because the Sun Funds carried on their individual trades and businesses together.

Key Takeaways

While the decision is binding precedent only in the District of Massachusetts, the *Sun Capital* case raises several significant implications for private equity firms. In particular, firms should exercise care when investing in portfolio companies maintaining or contributing to Title IV pension plans (i.e., both multiemployer and single employer pension plans), including performing due diligence and negotiating indemnification provisions for pension obligations. Further, while the IRS has yet to formally respond to the *Sun Capital* decision, the decision raises questions regarding minimum coverage and nondiscrimination testing requirements under the Code. *Sun Capital Partners III LP v. New England Teamsters & Trucking Indus. Pension Fund* (D. Mass., 2016).

Supplemental Retirement Agreement Subject to ERISA preemption. A South Carolina district court recently ruled that ERISA preempted state breach of contract claims filed by a former bank president. The case arises out of a dispute over a "Salary Continuation Agreement" between the executive and the bank that provided for supplemental retirement benefits in the form of twenty annual payments of $210,000, commencing at age 71. Following the executive's 71st birthday, the required monthly installments began as scheduled and continued through May 2015. At that time, the bank notified the executive that payments would cease. The executive filed suit in state court, alleging various state law violations, including breach of contract and unjust enrichment. The bank promptly acted to remove the action to federal court, on the grounds that the complaint is preempted by ERISA. The executive objected, maintaining that his claims are not governed by ERISA because the plan is an ERISA-exempt "excess benefit plan," that is, "a plan maintained by an employer solely for the purpose of providing benefits for certain employees in excess of the limitations on contributions and benefits imposed by section 415" of the Internal Revenue Code (Code).

To determine the status of the plan in question, the district court first turned to case law, noting that federal courts have repeatedly emphasized that an excess benefit plan is, by definition, one maintained "solely" for the purpose of providing benefits beyond the contribution limits imposed by Code Section 415. Moreover, some courts have held that a plan must specifically refer to Code Section 415 if it is to qualify as an excess benefit plan. Other courts have analyzed the clearly stated purpose or purposes of a plan "as determined by its plain language." According to the court, the plan in this case failed to qualify under any of the key tests. First, the plan makes no reference to either Code Section 415 or its substantive provisions. Rather, it clearly states that its objective is "to encourage the Executive to remain an employee of the Bank." It also specifically references the executive's right to bring a civil action under ERISA in the event of an adverse benefit determination. Accordingly, the court concluded that the plan is not an excess benefit plan enacted solely to avoid the contribution limits of Section 415, but rather a benefit plan for a valuable employee, created "as a means to entice the individual to remain in his post and subject to ERISA's enforcement provisions." The case will remain in federal court under ERISA preemption rules. *Shepherd v. Community First Bank* (D. So.Car., 2016)