Legislative & Regulatory Update

The ESOP Association Northwest Chapter Conference
September 28, 2017

Overview

Litigation Update

- *Brundle v. Wilmington Trust, N.A. (E.D.Va. March 13, 2017)*
- *Cal. Pub. Emps.' Ret Sys. V. ANZ Sec., 137 S. Ct. 2042 (2017)*
- *Acosta v. Vinoskey (W.D. Va. May 15, 2017)*
- *Pioneer Centres Holding Co. ESOP v. Alerus Financial & Alerus Financial v. Brewer (10th Cir. June 5, 2017)*
- *Neil v Foster-Bey (E.D. Va. Jan. 10, 2017)/CSR, Inc. v Foster-Bey (E.D. Va. May 10, 2017)*
- *Hugler v. First Bankers Trust Services (Rembar) (S.D. N.Y. Mar. 29, 2017)*
- *Pfeifer v. Wawa (E.D. Pa. Oct. 6, 2017)*

Litigation

Brundle v. Wilmington Trust, N.A. (E.D.Va. March 13, 2017)

Company: Constellis Group

- ESOP Purchased 100% of company stock in Dec. 2013 for $201MM, company sold to competitor 6 months later.
- Court denied cross-motions for SJ, the parties proceeded to a 6 day trial.
- Result: Ct. held Wilmington Trust liable for a PT is approving the ESOP purchase in excess of FMV.
- On 6/23/17 the Court denied a motion for reconsideration by the Trustee and ruled on plaintiff's attorney fee petition.

Litigation

Brundle v. Wilmington Trust, N.A. (E.D.Va. March 13, 2017)

This holding is about valuation and the Trustee's failure to investigate and consider various elements of the valuation report.

Specifically, the Court held that the Trustee failed to:

- Adequately consider the pre-transaction valuation report for 2013
- Investigate its financial advisor's reliance on the Company's financial projections.
- Consider the appropriateness of the control premiums applied
- Probe the financial advisor's practice of "rounding up" certain estimates

Litigation

Brundle v. Wilmington Trust, N.A. (E.D.Va. March 13, 2017)

Court found $29.7MM in total damages for overpayment by the ESOP, despite the fact that there was "no evidence…that the participants in this ESOP have actually suffered a loss."

The case considers each item that the Trustee did not properly consider and arrived at a value for each component that add up to the total damage award. These elements were reviewed again in the 6/23/17 decision, but no adjustments were made to the damages figure.

Attorney Fees: The Court awards $1.8MM in attorney fees to plaintiff, who initially claimed $2.8MM in fees. Costs of $600k were denied due to lack of documentation.

Plaintiff had agreed to a 1/3 contingent fee arrangement with counsel, but the Court held that this fee must first be submitted to the ESOP participants for an opportunity to object to the fee as per typical class action settlement proceedings.

Litigation

Cal. Pub. Emps.' Ret Sys. V. ANZ Sec., 137 S. Ct. 2042 (2017)

Notable in that the Supreme Court made a decision affecting ERISA plans.

Technical decision regarding time-frames during which plan participants MUST file suit on their own if they elect not to participate in the class action: "Does the filing of the main class action count as the filing for the individual that opts out or does the party that wants to opt out have to file its own complaint before the [ERISA 6 year] deadline?" (Ronald Mann, www.scotusblog.com)

Court held that ERISA 413 is a statute of repose – so that it begins to run on the "date of the last culpable act or omission of defendant."

Litigation

Acosta v. Vinoskey (W.D. Va. May 15, 2017)

- Company: Sentry Equipment Erectors, Inc. ESOP Trustee: Evolve Bank & Trust
- Second Stage ESOP Transaction
- ESOP Purchased 52% of Company at $406 per share for a total price of $20.7MM
- Second Stage Price was $131 higher than any surrounding valuation
- Almost 1/3 higher than the next highest valuation

Litigation

Acosta v. Vinoskey (W.D. Va. May 15, 2017)

- May 15 Opinion was on a Motion to Dismiss one of the defendants
- DOL named Michael New, the lead Trust Officer for Evolve in the transaction, personally as a Defendant in the suit
- Mr. New filed a Motion to Dismiss, arguing that he was acting in his role as employee of the named fiduciary, Evolve, and should not be an individual defendant.
- Court Denied the Motion to Dismiss

Litigation

Acosta v. Vinoskey (W.D. Va. May 15, 2017)

- Why is this case important?
- The individual employees of the corporate trustee should not typically be on the hook for actions taken on behalf of their employer within the scope of their job duties
- Why did the Court Deny the Motion to Dismiss?
- On Motion to Dismiss, allegations in complaint are assumed to be true
- Allegations must be enough to raise a right to relief that is more than speculative
- Complaint alleged that Mr. New had:
- independent discretionary authority to approve the price
- he was not required to get the approval from the Evolve Trust Committee to proceed with the transaction

Litigation

Acosta v. Vinoskey (W.D. Va. May 15, 2017)

- The Court looked to ERISA's functional fiduciary test
- If true, the allegations in the complaint meant Mr. New would be an ERISA fiduciary
- ERISA requires that any person having actual discretionary authority over the Plan is a *de facto* fiduciary regardless of the official title or role of such person
- Court refused to consider Mr. New's evidence:
  - Trust Committee Minutes
  - Stock Purchase Agreement
  - Arkansas Banking Regulations
- Summary Judgement is generally the next step in the litigation process, and all of the evidence the court refused to consider here should be included at that phase

Litigation

Pioneer Centres Holding Co. ESOP v. Alerus Financial, N.A. (10th Cir. June 5, 2017) & Alerus Financial, N.A. v. Brewer et al (10th Cir. June 5, 2017)

- Company: Pioneer Centres Holding Co. Auto dealership in Colorado and California.
- Trustee: Alerus Financial

ESOP appealed the lower court judgment granting summary judgment to Alerus.

The potential ESOP transaction (taking plan from 37.5% to 100% ownership) did not actually close because Land Rover would not approve the change in control under their dealership agreement – largely because LR was not made aware of the initial change in ownership.

Litigation

Pioneer Centres Holding Co. ESOP v. Alerus Financial, N.A. (10th Cir. June 5, 2017) & Alerus Financial, N.A. v. Brewer et al (10th Cir. June 5, 2017)

District Court granted SJ for Alerus because the Plan was unable to show a loss:

- the Company ended up selling all assets to another dealership company for $10MM more than the ESOP would have paid for the stock; and
- the Plan could not show that Land Rover would have approved the deal.

In Alerus's cross-motion against Matthew Brewer, the founder of Pioneer and majority shareholder, the Trustee argued that it was entitled to contribution and indemnification from Brewer and the other trustees and committee members (the 3rd party defendants)

Litigation

Pioneer Centres Holding Co. ESOP v. Alerus Financial, N.A. (10th Cir. June 5, 2017) & Alerus Financial, N.A. v. Brewer et al (10th Cir. June 5, 2017)

Alerus alleged that the 3rd party defendants committed a fiduciary breach under ERISA and should contribute their culpable share to any Plan losses because the 3rd party defendants knew that Alerus's actions could be found to be a breach of its fiduciary duty, but did nothing to remedy such breach.

District Court held that there is no right to contribution under ERISA even if the 3rd party defendants were found to be co-fiduciaries.

Ended up a moot point since Alerus's grant of SJ was upheld at the Circuit Court.

Litigation

Neil v Foster-Bey (E.D. Va. Jan. 10, 2017)/CSR, Inc. v Foster-Bey (E.D. Va. May 10, 2017)

- Company: CSR, Inc.
- Defendant, Foster-Bey, served as President, CEO, Board member and ESOP Trustee
- Board attempted to remove Defendant from all positions for allegedly neglecting his management, Board and Trustee duties
- Defendant allegedly appointed new Board members to prevent his own termination and continued holding himself out as CEO, Board member and Trustee of CSR.
- The original Board met to remove Foster-Bey, three weeks later the new Board members met with Foster-Bey to rescind the actions of the prior Board, and the following month the original outside Board members met to remove the newly appointed members.

Litigation

Neil v Foster-Bey (E.D. Va. Jan. 10, 2017)/CSR, Inc. v Foster-Bey (E.D. Va. May 10, 2017)

- Neil, one of the original Board members, filed suit on behalf of CSR against Foster-Bey for breach of fiduciary duties and injunctive relief
- In the January 10, 2017 decision, Foster-Bey's motion to dismiss was denied
- Foster-Bey made counterclaims against Neil/CSR for injunctive relief and declaratory judgement that would essentially reinstate him in his roles as CEO, Director and Trustee
- The decision on May 10, 2017 was a denial of CSR's motion to dismiss Foster-Bey's counterclaims

Litigation

Neil v Foster-Bey (E.D. Va. Jan. 10, 2017)/CSR, Inc. v Foster-Bey (E.D. Va. May 10, 2017)

- Why were the motions denied?
- In both considerations, the court could not conclude that the allegations in the original complaint and the counter claim were without merit
- Therefore, the case will proceed to summary judgement or trial

Litigation

Neil v Foster-Bey (E.D. Va. Jan. 10, 2017)/CSR, Inc. v Foster-Bey (E.D. Va. May 10, 2017)

- Basis of Denial of Motion to Dismiss by Foster-Bey on January 10
- Case Law is unsettled on whether a trustee of an ESOP necessarily violates his/her fiduciary duty by voting the ESOP's shares in a self-interested manner
- Several lower courts have held that a trustee voting out of self-interest violates the duty of loyalty. See *O'Neill v Davis*, 721 F. Supp. 1013 (N.D. Ill. 1989), *Neil v. Zell*, 677 F. Supp. 1010 (N.D. Ill. 2009); *Newton v Van Otterloo*, 756 F. Supp. 1121 (N.D. Ind. 1991).
- The Sixth Circuit has held that given the dual roles of director and fiduciary, some self-interest is inherent and not necessarily a breach of fiduciary duty. See *Grindstaff v. Green*, 133 F.3d 416 (6th Cir. 1998).

Litigation

Neil v Foster-Bey (E.D. Va. Jan. 10, 2017)/CSR, Inc. v Foster-Bey (E.D. Va. May 10, 2017)

- Here the District Court denied the motion to dismiss, noting that "all courts… agree… that a trustee's self-interested use of his or her voting power… can violate the trustee's fiduciary duty."
- Allegations that Foster-Bey was an absentee CEO, if proven, would be sufficient to demonstrate that he breached his fiduciary duty by "us[ing] his power at Trustee to vote the stock… in a wholly self-interested matter, to the detriment of the Plan and its beneficiaries."

Litigation

Neil v Foster-Bey (E.D. Va. Jan. 10, 2017)/CSR, Inc. v Foster-Bey (E.D. Va. May 10, 2017)

- Basis of Denial of Motion to Dismiss by CSR on May 10
- Allegations are based primarily on violations of:
  - the bylaws meeting notice and subject matter provisions
  - the trust agreement notice provisions for terminating a trustee
  - discrepancies between the bylaws and state law requirements for removal of directors
- These allegations, if true, call into question the validity of the corporate actions to remove Foster-Bey
- Therefore, the court denied the motion as Foster-Bey plausibly alleges that the original board members have breached both the bylaws and the trust agreement

Litigation

Hugler v. First Bankers Trust Services, Inc. & Rembar ESOP (S.D. NY March 29, 2017)

Company: Rembar Company, Inc. Manufacturer and distributor of precision parts and components made from refractory metals.

Trustee: First Bankers Trust Services

- Empire Valuation Consultants was hired by Rembar's ESOP formation committee to provide a preliminary valuation at the suggestion of Corporate Solutions Group (CSG)
- Trustee, Company, and selling shareholders entered into a Limitation Agreement which required that so long as the Seller Promissory Note to Frank Firor (the CEO, chairman, president and majority shareholder) was outstanding, the Trustee would vote for a board of directors that was comprised of a majority designated by Mr. Firor.

Litigation

Hugler v. First Bankers Trust Services, Inc. & Rembar ESOP (S.D. NY March 29, 2017)

- On 6/17/05, the Trustee purchased 100% of Rembar's stock for $15.5MM using an exempt loan from the Company (28 year amortization).
- Rembar met its debt obligations until 2009. Upon restructuring in July, 2009, the ESOP surrendered the unallocated shares it had purchased in 2005. Rembar purchased the allocated shares from the Plan for $15,500 and terminated the ESOP.

The Secretary of Labor filed suit alleging that FBTS and Firor breached their fiduciary duties under ERISA, entered into a PT, and that Firor was subject to disgorgement of amounts received in the 2005 transaction.

FBTS moved for SJ, and the DOL Secretary cross-moved for partial SJ.

Litigation

Hugler v. First Bankers Trust Services, Inc. & Rembar ESOP (S.D. NY March 29, 2017)

- Secretary claims
  - FBTS authorized the ESOP to pay too much for the Rembar stock
  - The Trustee's reliance on Empire's valuation was imprudent because it was not truly independent – due to its initial engagement with the ESOP exploratory committee.
- FBTS claims
  - Its conduct and internal procedures demonstrate a thorough investigation of the transaction with ample due diligence to satisfy its duties under ERISA.
  - It confirmed Empire used complete and accurate information in performing the valuation, and that Empire was qualified, experienced and had FBTS's full confidence with respect to its advisory and valuation capabilities.

Litigation

Hugler v. First Bankers Trust Services, Inc. & Rembar ESOP (S.D. NY March 29, 2017)

- The District Court held that neither party was entitled to SJ and scheduled the case for trial.
  - Since Empire had been initially hired by the formation committee that involved the selling shareholder, and because FBTS's engagement was conditioned on its using Empire as its financial advisor – this raises questions about Empire's independence.
  - There are questions of fact related to whether FBTS engaged in an appropriate negotiation process and determination of stock price.
  - There are also questions regarding the understanding of the parties related to the Limitation Agreement and whether it was prudent for FBTS to enter into that voting agreement – and whether it was appropriate to pay a control premium if the Trust did not have actual "control" following the transaction.
  - Economic Loss: the forgiveness of outstanding debt does not mitigate the amount that the trust may or may not have overpaid for the stock.

Litigation

Pfeifer v. Wawa, Inc. et al (E.D. Pa October 6, 2016)

- Group of terminated Wawa employees claim that the ESOP Trustees violated ERISA by amending the Plan to eliminate their right to hold Wawa stock in their ESOP account.
- The Plan was amended to divest terminated employees from Company stock and to no longer allow such employees to remain ESOP participants.
- This forced the sale of Company stock in their accounts at a value of $6,940 and charged a distribution fee.

Anti-cutback issue

- There is no right to a particular form of investment (cash vs. employer stock).
- The forced liquidation of the accounts goes beyond an investment choice, therefore the court held that the Company's motion to dismiss this charge was denied.

Litigation

Pfeifer v. Wawa, Inc. et al (E.D. Pa October 6, 2016)

Stock Valuation issue

- Company's financial advisor, Duff & Phelps valued the stock between $7000 - $7900 per share in 2014, above the forced sale price.
- Plaintiffs assert that the forced sale price was too low, and was stale by the date of the liquidation because it was based on a June, 2015 appraisal. Also, they were charged a $50 distribution fee. Court denies defendant's motion to dismiss on the valuation issue.

Indemnification issue

- If Wawa indemnifies the fiduciary defendants, the plaintiffs claim that the value of their stock will decrease as a result.
- References the view that indemnification by an ESOP sponsor functionally equates to an impermissible indemnification by the ESOP itself.

Regulatory Update

- DOL Subpoena power
- Volume Submitter Program for ESOPs