

When Representations Regarding the Financial Condition of the Plan Sponsor Become Actionable Under ERISA

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The U.S. District Court for the Northern District of California ruled in December 2009 that statements made by an officer of Delta Star, Inc. (Company) regarding the financial condition and anticipated performance of the Company, which was also the plan sponsor of the Delta Star, Inc. Employee Stock Ownership Plan (ESOP), were sufficiently connected to benefits payable under the ESOP so as to be actionable as a fiduciary breach under ERISA.¹

The plaintiff, John Balsley, was a participant in the ESOP and held 58,910 shares of Company stock in his ESOP account. As of December 31, 2006, the per share value for the shares of Company stock held by the ESOP was determined to be \$22.38. John Green, CFO of the Company, contacted the plaintiff on two separate occasions in October 2007 and offered a lump-sum buyback of the stock held in the plaintiff's ESOP account. The offer was based on the December 31, 2006 valuation. In his communications with the plaintiff, the CFO indicated that (1) cash may not be available in future to buy back the ESOP shares and (2) the lump-sum offer would not remain open. However, according to the court, the CFO failed to advise the plaintiff that (1) "Delta Star was having a record sales year with record gross profits and net sales increasing over 50%"² and that (2) "[E]ven though annual valuation [for 2007] had not been completed, based on the increased gross profits and revenue, Delta Star's stock [value] had increased."³

On November 26, 2007, the plaintiff received a lump-sum distribution from the ESOP in the amount of \$1,318,422.15. As of December 31, 2007 the per share value for the shares held by the ESOP was \$142.45. If the plaintiff's distribution had been based upon the December 31, 2007 valuation, the plaintiff would have received \$8,391,729.50, a difference of \$7,072,307.35.

The plaintiff sued the ESOP, the trustees of the ESOP, the Company, and the CFO (defendants), alleging two material misrepresentations and further alleging two material omissions by the defendants.

Misrepresentations

- (1) "[C]ash may not be available in the future to buy Balsley's shares from the ESOP."⁴
- (2) "[T]he opportunity to cash in his shares... would not remain open."⁵

¹ *Balsley v. Delta Star Employee Stock Ownership Plan*, C09-2952 TEH (N.D. Cal., Dec. 10, 2009).

² *Balsley*, slip op. at 2.

³ *Id.* at 6.

⁴ *Id.* at 7.

Omissions

- (1) “Delta Star was having a record sales year with record gross profits and net sales increasing over 50%.”⁶
- (2) “[E]ven though annual valuation [for 2007] had not been completed, based on the increased gross profits and revenue, Delta Star’s stock [value] had increased.”⁷

The defendants sought to dismiss on the basis that the plaintiff’s allegations failed to state a claim upon which relief can be granted. The defendants argued that the plaintiff claimed two material omissions in the information presented to him were not actionable, because the omitted information relates only to the operations of the Company in which the ESOP invests and are therefore not “with respect to a plan,” as required by the Employee Retirement Income Security Act of 1974 (ERISA).

Previous case law established upon similar facts⁸ warns companies against “*intentionally*” connecting statements regarding the financial health of the company to statements about the future of benefits. Doing so may result in “[the company’s] intended communication about the security of benefits [being] rendered ‘materially misleading’ and ‘an act of plan administration’.” In light of this prior case law, the *Delta Star* court found that “when the allegations are viewed in a light most favorable to Plaintiff, as required at this stage of the proceedings, they suggest that [Plaintiff] was encouraged to accept the lump-sum distribution based on the December 31, 2006 stock valuation in part because Delta Star had a questionable financial future that might or would preclude a future lump-sum offer.”⁹ So the allegations made by the plaintiff “reflect an intentional connection between the lump-sum offer to [the plaintiff] and the financial outlook of [the Company] and are therefore actionable under ERISA.”¹⁰

In addition, the court determined that the alleged misrepresentation that the ESOP would not offer a lump-sum option in the future is also actionable since the terms of the ESOP allow the trustees to determine each year whether to allow lump-sum distributions.

The court did find in favor of the defendants on the issue of the availability of cash to repurchase ESOP shares in the future, finding that the statement that cash may not be available in the future for a lump sum is not actionable, because increased sales and revenue do not necessarily translate into increased cash availability, so it is not plausible that the defendants would have known with certainty whether cash would be available to offer a lump-sum distribution in the future.

The court also dismissed the plaintiff’s claim under ERISA 502(a)(2), which provides a remedy for fiduciary breaches that cause a loss to the plan but “does not provide a remedy for individual injuries distinct from plan injuries.”¹¹

Recent case law has permitted suits under ERISA 502(a)(2) for fiduciary breaches that impair the value of plan assets in a participant’s individual account.¹² The court found that the plaintiff offered no arguments that showed how the alleged breach of fiduciary duty “impaired the value of the Plan’s assets;

⁵ *Id.*

⁶ *Id.* at 6.

⁷ *Id.*

⁸ *Varity Corp. v. Howe*, 516 U.S. 489 (1999).

⁹ *Balsley*, slip op. at 6.

¹⁰ *Id.*

¹¹ *Id.* at 4.

¹² *Citing LaRue v. DeWolff, Bobert & Assocs., Inc.*, 128 S. Ct. 1020, 1026 (2008).

he does not, for instance, assert that Defendants' alleged conduct in any way decreased the value of [Company] stock held in the Plan."¹³ Thus, while case law has permitted individuals to pursue litigation under ERISA 502(a)(2), the *Delta Star* court requires that a suit under ERISA 502(a)(2) must show a loss in value to the plan in order to proceed.

If you have any questions or would like more information on any of the topics discussed in this LawFlash, please contact any of the following Morgan Lewis attorneys:

Chicago

David Ackerman	312.324.1170	dackerman@morganlewis.com
Theodore M. Becker	312.324.1190	tbecker@morganlewis.com
Brian D. Hector	312.324.1160	bhector@morganlewis.com
Elizabeth S. Perdue	312.324.1180	eperdue@morganlewis.com
Louis L. Joseph	312.324.1726	louis.joseph@morganlewis.com

Dallas

Riva T. Johnson	214.466.4107	riva.johnson@morganlewis.com
John A. Kober	214.466.4105	jkober@morganlewis.com
Erin Turley	214.466.4108	eturley@morganlewis.com

Los Angeles

Scott E. Adamson	213.612.7365	sadamson@morganlewis.com
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San Francisco

Nicole A. Diller	415.422.1312	ndiller@morganlewis.com
D. Ward Kallstrom	415.422.1308	dwkallstrom@morganlewis.com

Washington, D.C.

Gregory C. Braden	202.739.5217	gbraden@morganlewis.com
Daniel L. Hogans	202.739.5510	dhogans@morganlewis.com
Gary B. Wilcox	202.739.5509	gwilcox@morganlewis.com

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¹³ *Balsley*, slip op. at 6.

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