LEGAL *Update*

Legal Update for April 2014

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District Court Dismisses Money Damages and Injunctive Relief Claims of DOL Against ESOP Valuation Firm

On December 13, 2013, the Federal District Court for the Northern District of Florida, Pensacola Division, issued an Order in *Perez v. Oden and Thielking, C.P.A.s, PC, et. al.*, (N.D. Fla. December 13, 2013) and dismissed all claims of the Department of Labor ("DOL") brought against Oden and Thielking, C.P.A.s, PC and its principal, Stephen K. Thielking (collectively, the "Valuation Firm"). The Order provides an excellent discussion of the DOL's ability to seek money damages, injunctive relief and/or "other appropriate equitable relief" against a non-fiduciary ESOP service provider, such as a valuation firm, under ERISA.

The DOL's complaint was brought against Robert S. Caputo, D.O., P.A. (as ESOP sponsor), Robert S. Caputo (the sponsor's sole officer and director), Glenn M. Bankert (the ESOP trustee) and the Valuation Firm. At the heart of the case was that although Dr. Caputo sold all of the corporation's stock to the Robert S. Caputo, D.O. Employee Stock Ownership Plan (the "ESOP"), he continued to regularly use the corporation's checking account to pay substantial personal expenses. Dr. Caputo did not issue promissory notes for these amounts, but the corporation's accountant recorded them as an asset on the corporation's balance sheet as "advances to officer." This asset was by far the largest asset on the balance sheet. The Valuation Firm used a book value approach to value the common stock owned by the ESOP, and accordingly, this receivable for the doctor's personal expenses had a dramatic upward impact on the valuation.

The DOL obtained a separate consent judgment against Dr. Caputo and Dr. Bankert for $225,000, but continued the case against the Valuation Firm alleging that the inflated valuations caused the ESOP to pay more than adequate consideration for stock it purchased from terminating participants, which would be a prohibited transaction.

As the trial date approached, the DOL attempted to change its theory of recovery against the Valuation Firm. At the pre-trial conference, the DOL conceded that the Valuation Firm had not participated in a prohibited transaction and was not an ESOP fiduciary (two concessions that are at the heart of the District Court's Order). The DOL instead alleged that the valuations helped conceal Dr. Caputo's misappropriation of corporate assets, and as a result, the Valuation Firm should be liable for their knowing participation in the fiduciary breaches of Dr. Caputo and Dr. Bankert.

The case was brought under the civil enforcement provision of ERISA Section 502(a)(5) which provides that the Department of Labor may bring a civil action "(A) to enjoin any <u>act or practice which violates</u> any provision of this title, or (B) to obtain other <u>appropriate equitable relief</u> (i) to <u>redress such violation</u> or (ii) to enforce any provision of this title; .."[emphasis added]. The Court framed the key issue in this case as "whether Section 502(a)(5)...authorizes a suit against a non-fiduciary for appropriate equitable relief on grounds of a non-fiduciary's 'knowing participation' in a breach of fiduciary duty ...in the absence of a 'prohibited transaction'..."

After reviewing and discussing several prior court decisions, the District Court dismissed all claims against the Valuation Firm and held that the DOL failed to state a claim upon which relief can be granted under ERISA because (1) there had been no prohibited transaction by the Valuation Firm, (2) there was no "act or practice" by the Valuation Firm that violated ERISA, and (3) the remedy sought (disgorgement of professional fees and an injunction to prohibit all future valuation work for ERISA covered plans) would not be "appropriate equitable relief" under ERISA Section 502(a)(5).

In support of its decision, the District Court relied upon two Eleventh Circuit Court of Appeals and two U.S. Supreme Court decisions. In *Useden v. Acker*, 947 F.2d 1563 (11th Cir. 1991), *cert. denied*, 508 U.S. 959 (1993), the Court of Appeals ruled in favor of a non-fiduciary lawyer (a service provider) and stated that such a non-fiduciary could not be held liable for <u>money damages</u> either for a breach of fiduciary duty (since he was not a fiduciary) or for knowingly engaging in a prohibited transaction (finding that ERISA only permits "appropriate equitable relief," not money damages, against a non-fiduciary in such situation). The U.S. Supreme Court reached a similar result two years later in *Mertens v. Hewitt Assocs.*, 508 U.S. 248 (1993) in which it held that ERISA makes only fiduciaries and co-fiduciaries personally liable for <u>monetary damages</u> to the plan for breach of fiduciary duty. The Supreme Court did note in dicta in *Mertens* that non-fiduciaries could be required to disgorge assets and profits obtained through a prohibited transaction, could be enjoined from participating in a fiduciary's breach and could be forced to make restitution. However, by attempting to require the Valuation Firm

here to repay its contractual fees and to permanently ban it from performing valuations for ERISA covered plans, the DOL was said to be seeking money damages and injunctive relief against a non-fiduciary, neither of which fall within the scope of ERISA's "appropriate equitable relief."

In 1998, the Eleventh Circuit ruled in favor of the DOL in *Herman v. South Carolina Nat'l Bank*, 140 F.3d 1413 (11th Cir. 1998), *cert. denied*, 525 U.S. 1140 (1999) and permitted the DOL to bring suit for equitable relief against a non-fiduciary who had participated in a prohibited transaction. The case highlighted that in order for relief to be granted under ERISA Section 502(a)(5), the non-fiduciary must engage in an "act or practice which violates" ERISA. Engaging in a prohibited transaction is such an "act or practice," but negligently preparing a substandard valuation report is not an act regulated by, or in violation of, ERISA. Thus, in the case of the Valuation Firm, even if their valuation work was substandard, negligence by a mere service provider is not actionable under ERISA. The 2000 U.S. Supreme Court case of *Harris Trust and Savings Bank v. Solomon Smith Barney, Inc.*, 530 U.S. 238 (2000), again allowed equitable relief against a non-fiduciary who participated in a prohibited transaction. The *Harris Trust* case reminded us that although the scope of permissible defendants is broad, the relief is limited to "appropriate equitable relief." Money damages against a mere service provider generally are not actionable under ERISA.

The Northern District of Florida concluded that even if a non-fiduciary service provider engages in an act or practice which violates ERISA, the type of recovery is limited. Traditional money damages are not recoverable under ERISA Section 502(a)(5) except from a fiduciary or co-fiduciary. This case provides welcome guidance for nonfiduciary service providers. It should be noted however, that, if the Department of Labor is able to modify the fiduciary regulations as it intends to define valuation firms as ERISA fiduciaries, the Valuation Firm in this case could be liable for monetary damages.

The author reviewed this article with Committee Chair, Steven B. Greenapple, Steiker, Fischer, Edwards & Greenapple, P.C., Cedar Knolls, NJ.

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