

Washington University Law Review

Volume 64
Issue 3 *Time, Property Rights, and the Common Law*

January 1986

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Recommended Citation

Randy L. Gegelman, *The ERISA Trustee: Saying “No” to a Tender Offer*, 64 WASH. U. L. Q. 953 (1986).
Available at: https://openscholarship.wustl.edu/law_lawreview/vol64/iss3/11

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NOTES

THE ERISA TRUSTEE: SAYING “NO” TO A TENDER OFFER

The threat of a tender offer¹ continues to influence modern business practice. In addition, the amount of assets held in employee-benefit plans continues to expand.² Sponsor stock constitutes a significant portion of such assets.³ When a tender offeror directs his efforts at the sponsor corporation, plan trustees must decide whether to retain or tender plan-held shares.⁴ Whatever their response, the trustees must comply with the fiduciary standards contained in The Employee Retirement Income Security Act (ERISA).⁵

This Note considers the propriety of refusing to tender plan-held shares. Part I highlights ERISA's purpose and structure. Part II explains ERISA's fiduciary standards. Part III examines the proper trustee response, recommends that trustees conduct a two-step analysis in responding to a tender offer, and argues that courts should show great deference to ERISA trustee decisions to retain plan-held shares.

1. The definition of a “tender offer” remains somewhat uncertain. The Security Exchange Commission suggests seven characteristics for courts to examine. *See Wellman v. Dickinson*, 475 F. Supp. 783, 823-24 (S.D.N.Y. 1979). *See generally Current Issues in Tender Offers, The Elusive Definition of a Tender Offer*, 7 J. CORP. L. 503 (1981).

2. Expenditures for private pension plans will amount to \$450 billion between 1986 and 1990. Plans' current holdings exceed \$1 trillion and represent one-half of the nation's investment capital. Sheppard, *Ways and Means Subcommittees Consider Retirement Income Security*, TAX NOTES, July 22, 1985, at 391.

3. The Employee Retirement Income Security Act of 1974 (ERISA) allows ERISA qualified plans to hold up to 10% of the fair market value of plan assets as sponsor stock. ERISA § 407(a)(2), 29 U.S.C. § 1107(a)(2) (1982). A plan “sponsor” means an employer that sponsors the employee benefit plan. *Id.* at § 3(16)(B), 29 U.S.C. § 1002(16)(B).

4. Most employee benefit plan assets must be held in trust by one or more trustees. Subject to stated exceptions, the trustees must possess exclusive authority and discretion over such assets. ERISA § 403(a), 29 U.S.C. § 1103(a) (1982). A “defined contribution” plan may permit a participant to exercise control over assets in his account and thereby relieve the trustee from liability. *Id.* at § 404(c), 29 U.S.C. § 1104(c) (1982). In a tender offer context, target companies have amended plans to provide for participant direction. *See Davis & Daniel, Limiting the Potential Liability of a Plan Trustee in the Event of a Takeover Attempt*, 9 J. PEN. PLAN. & COMP. 269, 276 (1983). For the definition of “defined contribution” plan, *see infra* note 15.

5. Pub. L. No. 93-406, 88 Stat. 829 (codified at 29 U.S.C. §§ 1001-1461 (1982)).

I. STRUCTURE AND PURPOSE

Congress enacted ERISA in response to the substantial growth in size, scope and numbers of employee benefit plans in recent years.⁶ Congress intended to protect plan beneficiaries from abuse and financial instability.⁷ To accomplish this goal, Congress included specific standards governing fiduciary conduct.⁸ A plan trustee must comply with these standards in distributing benefits and determining trust investment policy.⁹ ERISA imposes liability for failures to comply with fiduciary responsibilities.¹⁰

In addition to fiduciary standards, Congress included other provisions designed to protect beneficiaries in ERISA and the corresponding Internal Revenue Code sections. For example, coverage provisions require the sponsor to allow a minimum percentage of employees to participate in the plan.¹¹ Minimum participation standards prohibit the sponsor from conditioning participation on burdensome age and service requirements.¹² Congress also required that an employee's right to benefits must vest within a stated number of years.¹³ Congress did not, however, require a sponsor to provide a minimum level of benefit. ERISA's protec-

6. See ERISA § 2, 29 U.S.C. § 1001 (1982).

7. *Id.*, 29 U.S.C. § 1001 (1985). See H.R. REP. NO. 533, 93d Cong., 2d Sess. 1-5 (1973) [hereinafter cited as H.R. REP. NO. 533], reprinted in 1974 U.S. CODE CONG. & AD. NEWS 4639, 4639-43 (describing history of private pension system and inadequacies of then existing laws). See also Hutchinson, *The Federal Prudent Man Rule Under ERISA*, 22 VILL. L. REV. 15, 16-22 (1976-77) (discussing problems that prompted Congress to enact ERISA).

8. ERISA § 404, 29 U.S.C. § 1104 (1982). See *infra* notes 22-28 and accompanying text.

9. In suits challenging the trustee's decision to deny benefits to a particular claimant, courts apply an "arbitrary and capricious" standard. See, e.g., *Elser v. I.A.M. Nat'l Pen. Fund.* 684 F.2d 648 (9th Cir. 1982), cert. denied, 464 U.S. 813 (1983). In a challenge to investment decisions, courts apply a "sole benefit" standard. See, e.g., *Struble v. N.J. Brewery Emp. Welfare Trust Fund*, 732 F.2d 325 (3d Cir. 1984). See generally Comment, *The Arbitrary and Capricious Standard Under ERISA: Its Origins and Application*, 23 DUQ. L. REV. 1033 (1985); Note, *Fiduciary Responsibility: Prudent Investments Under ERISA*, 14 SUFFOLK U.L. REV. 1066 (1980).

10. ERISA § 409, 29 U.S.C. § 1109 (1982). The Secretary of Labor, participants, beneficiaries and fiduciaries can seek relief under § 409. ERISA § 502(a), 29 U.S.C. § 1132(a) (1982).

11. I.R.C. § 410(b)(1) (1982) requires that 70% of all employees, or at least 80% of all eligible employees if at least 70% of all employees are eligible to participate, must benefit. A plan need not comply with the percentage tests if the coverage it provides does not favor the group consisting of officers, shareholders and highly compensated employees. I.R.C. § 410(b)(2) (1982).

12. I.R.C. § 410(a)(1) (1982) disallows a tax qualified plan from conditioning participation on periods of service extending beyond an employee's 21st birthday or 1 year employment anniversary, whichever is later. *Id.* See also ERISA § 202(a)(1), 29 U.S.C. § 1052(a)(1) (1982).

13. I.R.C. § 411(a) (1982) establishes alternative vesting schedules limiting the number of years over which an employee's accrued benefit must become nonforfeitable. *Id.* See also ERISA § 203(a), 26 U.S.C. § 1053(a) (1982). Internal Revenue Code sections 410 and 411 impose minimum

tions apply only to the benefit level the employer chooses to provide.¹⁴

Employee-benefit plans derive funds from two sources—required contributions and investment return. The type of established plan determines the significance of each fund source. In a “defined-contribution” plan,¹⁵ employer contribution levels are fixed. The investment return on these fixed contributions significantly affects the ultimate employee benefit.¹⁶ In a “defined-benefit” plan,¹⁷ employee benefit levels are predetermined on the basis of a set formula. The investment return on employer contributions does not affect the ultimate benefit received. Rather, in a defined-benefit plan, a successful investment strategy serves only to reduce employer contribution amounts.¹⁸

II. ERISA’S FIDUCIARY STANDARD

Common-law trust principles provide the foundation for ERISA’s fiduciary standards.¹⁹ The common law requires a trustee to manage trust assets in a “prudent” manner.²⁰ In addition to prudence, the common law demands that a trustee act with complete loyalty.²¹ The trustee must

requirements necessary for the plan to qualify for favorable tax treatment. *See* I.R.C. § 401(a) (1982).

14. *See* Alessi v. Raybestos-Manhattan, Inc., 451 U.S. 504 (1981).

15. A “defined-contribution” plan is a “plan which provides for an individual account for each participant and for benefits based solely upon the amount contributed to the participant’s account, and any income, expenses, gains and losses. . . .” ERISA § 3(34), 29 U.S.C. § 1002(34) (1982). An employee stock ownership plan is a special form of defined contribution plan designed to invest primarily in employer securities. *See* ERISA § 407(d)(6), 29 U.S.C. § 1107(d)(6) (1982).

16. *See* G. BOREN, QUALIFIED DEFERRED COMPENSATION PLANS § 1:09 (1983). Employer contributions are typically set as a percentage of employee compensation. Investment gains and losses do not affect employer contribution amounts. *Id.* Thus, “investment experience” plays a key role in employee benefit levels. *Id.*

17. A “defined-benefit” plan is a “plan other than a [defined-contribution plan].” ERISA § 3(35), 29 U.S.C. § 1002(35) (1982).

18. Employee benefits are typically set as a flat sum or percentage of compensation based on number of service years. *See* G. BOREN, *supra* note 16, at § 1:07. Employee turnover, post-retirement mortality and investment return affect employer contribution levels. *Id.* *See also* Note, *Fiduciary Standards and the Prudent Man Rule Under the Employment Retirement Income Security Act of 1974*, 88 HARV. L. REV. 960, 961-62 (1975).

19. *See* H.R. REP. NO. 533, *supra* note 7, at 13, *reprinted in* 1974 U.S. CODE CONG. & AD. NEWS 4639, 4651 (Congress adopted common law fiduciary standards “with modifications appropriate for employee benefit plans”).

20. *See* A. SCOTT, THE LAW OF TRUSTS §§ 174 & 227 (3d ed. 1967). *See generally* Shattuck, *The Development of the Prudent Man Rule for Fiduciary Investment in the United States in the Twentieth Century*, 12 OHIO ST. L.J. 491 (1951) (examining the history of the prudence standard).

21. *See* A. SCOTT, *supra* note 20, at § 170.

administer the trust solely in the interest of the income beneficiaries and trust remaindermen.

ERISA binds an employee benefit trustee to similar duties.²² ERISA section 404(a)(1)(A) requires a plan trustee to discharge his duties for the exclusive purpose of providing benefits to participants and their beneficiaries.²³ This rule does not disallow incidental benefits to a third party. It does, however, prohibit the use of plan assets for the primary benefit of a party other than the plan itself.²⁴ In adopting the "exclusive purpose" rule, Congress codified the common-law trustee's duty of complete loyalty.²⁵

ERISA section 404(a)(1)(B) contains a modified version of the common law duty of prudence.²⁶ An ERISA trustee must act "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims."²⁷ In adopting the ERISA "prudent man" rule, Congress indicated that courts interpreting this rule should consider "the special nature and purpose of employee benefit plans."²⁸

III. THE TRUSTEE RESPONSE

A. Proper Procedure

Courts applying ERISA's fiduciary standards do not consider the outcome of the chosen investment policy. Rather, courts test the trustee's

22. ERISA § 404(a)(1), 29 U.S.C. § 1104(a)(1) (1982) provides:

(1) . . . a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and—

(A) for the exclusive purpose of:

(i) providing benefits to participants and their beneficiaries; and
(ii) defraying reasonable expenses of administering the plan;

(B) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims

23. 29 U.S.C. § 1104(a)(1)(A) (1982). See text of statute *supra* note 22.

24. See *Donovan v. Bierwirth*, 680 F.2d 263, 271 (2d Cir. 1982), *cert. denied*, 459 U.S. 1069 (1983) (actions can incidentally benefit the sponsor or the trustees if taken with "an eye single to the interests of the participants and beneficiaries"). Cf. *Treas. Reg. § 1.401-2(a)(3)* (1956).

25. See *supra* note 21 and accompanying text.

26. 29 U.S.C. § 1104(a)(1)(B) (1982).

27. *Id.* See text of statute, *supra* note 22.

28. See S. CONF. REP. NO. 1090, 93d Cong., 2d Sess. 302 (1974), *reprinted in* 1974 U.S. CODE CONG. & AD. NEWS 4639, 5083. See also *Marshall v. Teamsters Local 282 Pension Trust Fund*, 458 F. Supp. 986, 990 (E.D.N.Y. 1978) (citing Senate Conference Report).

decisionmaking process for evidence of loyalty and prudence.²⁹ Thus, the procedures employed in formulating a tender offer response will, in part, determine the legal sufficiency of the response.³⁰ Courts have developed standards that provide procedural guidance for trustees.

In *Donovan v. Bierwirth*,³¹ the Second Circuit addressed the propriety of trustee action in response to a tender offer. The trustees had refused to tender plan-held shares,³² and the Department of Labor challenged the trustees' action as a breach of fiduciary duty. The court held that the trustees' failure to conduct a thorough and independent evaluation violated section 404.³³ Thus, *Bierwirth* requires a trustee formulating a plan response to a tender offer to consider independently the best interests of the beneficiaries apart from the sponsor's tender offer policy and response.³⁴

In *Bierwirth*, the trustees decided not to tender after a mere half hour discussion.³⁵ The court found that the trustees had acted imprudently in failing to investigate thoroughly the merits of the tender offer.³⁶ In *Withers v. Teachers' Retirement System*,³⁷ a non-tender offer case, the court

29. See, e.g., *Donovan v. Cunningham*, 716 F.2d 1455, 1467 (5th Cir. 1983); *Marshall v. Glass/Metal Ass'n & Glaziers*, 507 F. Supp. 378, 384 (D. Hawaii 1980); *Leigh v. Engle*, 727 F.2d 113, 122 (7th Cir. 1984) (even an extraordinary investment return does not shield an imprudent trustee).

30. Commentators have thoroughly evaluated proper trustee procedure. See Comment, *Making a Prudent Response to a Tender Offer: The Corporation Trustee's Dilemma Under ERISA*, 32 AM. U.L. REV. 839 (1983) [hereinafter cited as *Prudent Response*]; Note, *The Duties of Employee Benefit Plan Trustees Under ERISA in Hostile Tender Offers*, 82 COLUM. L. REV. 1692 (1982) [hereinafter cited as *Trustee Duties*]; Note, *Employee Stock Ownership Plans and Corporate Takeovers: Restraints on the Use of ESOP's by Corporate Officers and Directors to Avert Hostile Takeovers*, 10 PEPP. L. REV. 731 (1983) [hereinafter cited as *Restraints*].

31. 680 F.2d 263 (2d Cir. 1982), cert. denied, 459 U.S. 1069 (1983).

32. *Id.* at 268. In *Bierwirth*, LTV Corp. offered \$45 per share for Grumman Corp. stock. At the time of the offer, the stock sold for between \$23 and \$27 on the New York Stock Exchange. *Id.* at 266. Grumman's plan was a defined benefit plan holding about 3.8% of Grumman's outstanding shares. *Id.* at 269.

33. *Id.* at 273. The trustees relied on a letter from Grumman directors to shareholders as a basis for their decision. The court found that the letter contained significant omissions relating to LTV's pension plans which an independent investigation would have revealed. *Id.*

34. Compare *Bierwirth* with *Withers v. Teachers' Retirement Sys.*, 447 F. Supp. 1248, 1258-59 (S.D.N.Y. 1978), *aff'd*, 595 F.2d 1210 (2d Cir. 1979) (finding a speculative investment as prudent partly because trustees personally reviewed reports and financial figures). Trustees may obtain the aid of independent counsel to provide some measure of protection. See Comment, *Prudent Response*, *supra* note 30, at 861.

35. *Bierwirth*, 680 F.2d at 268.

36. *Id.* at 273.

37. 447 F. Supp. 1248 (S.D.N.Y. 1978), *aff'd*, 595 F.2d 1210 (2d Cir. 1979).

approved trustee investment in speculative bonds.³⁸ The court reached this result in part because the trustees had conducted an extensive investigation.³⁹ Thus, the ERISA trustee must make a thorough assessment of the offer's merits.

Courts have not indicated which substantive factors a prudent trustee must consider in formulating a response. Some commentators suggest that resignation provides the only practical solution for a trustee serving in the dual role as corporate officer.⁴⁰ Although such suggestions lack practicality, the absence of judicial guidance may force this result.

B. Substance: An Argument for Wide Latitude

Courts traditionally interpret the common-law prudence standard to require a trustee to promote two investment goals: assurance of adequate return and protection of the trust corpus.⁴¹ Common-law trustees must balance these interests to assure financial security for the current income recipients and trust remaindermen.⁴² The traditional test of prudence requires the trustee to consider the possibility of investment gain and loss in deciding to purchase or sell an asset.⁴³

An ERISA trust does not create competing tensions between life beneficiaries and remaindermen.⁴⁴ However, an ERISA trustee faces analogous conflicts between current income recipients and future income

38. In *Withers*, the pension plan covering employees of New York City purchased over \$2.5 billion of city bonds. New York City, threatened with bankruptcy, would have had to default on its obligations to fund the plan. To avoid bankruptcy, the trustees agreed to purchase the speculative bonds. *Id.* at 1252-53.

39. *Id.* at 1259. Trustees should carefully document their reasons for specific actions. Lamon, *Professional Money Managers: Fiduciary Responsibility Under ERISA*, 11 REAL PROP., PROB. & TR. J. 519, 522 (1976). See generally Comment, *Prudent Response*, *supra* note 30, at 854-65 (examining factors courts will consider in evaluating trustees' response).

40. See Comment, *Prudent Response*, *supra* note 30, at 870 (despite all precaution, "a corporation trustee has a duty to resign . . . when his corporation is a target of a hostile takeover attempt").

41. See A. SCOTT, *supra* note 20, at §§ 176 & 181.

42. See, e.g., *Dennis v. R.I. Hosp. Trust Nat. Bank*, 744 F.2d 893 (5th Cir. 1984) (holding a trustee liable who had managed property so as to maximize income at the expense of property deterioration); *Peoples Trust Co. v. United States*, 311 F. Supp. 1197 (D.N.J. 1970), *aff'd*, 444 F.2d 193 (3d Cir. 1971) (holding that under state law a trustee owes equal duties to life beneficiary and remaindermen); *Commercial Trust Co. v. Barnard*, 27 N.J. 332, 142 A.2d 865 (1958) (noting that a trustee should preserve the trust estate while receiving reasonable income).

43. See Note, *supra* note 18, at 966-67. See also Note, *The Regulation of Risky Investments*, 83 HARV. L. REV. 603, 616-17 (1970) [hereinafter cited as *Risky Investments*] (the risk of loss runs throughout the various legal approaches).

44. Pension trusts are designed to provide only income benefits. The trust corpus does not pass to remaindermen. See Note, *supra* note 18, at 967 ("the central problem shaping the development of

beneficiaries. The trustee must provide current retirement payments in an impartial manner⁴⁵ and guard the actuarial soundness of the fund for future retirees.⁴⁶ Current investment income does not directly affect payments to current retirees.⁴⁷ Thus, in responding to a tender offer, the trustee must focus on the potential effects on future beneficiaries.

This Note proposes that a trustee employ a two-step analysis in responding to a tender offer. First, consistent with the common law, the trustee should consider the possibility of direct gain or loss.⁴⁸ The nature of ERISA trusts, however, diminishes the importance of these considerations.⁴⁹ Second, in a departure from the common law, the trustee must consider the effect on the plan and future income beneficiaries.⁵⁰ The trustee must guard participant expectations.

I. Gain or Loss

An ERISA trustee must consider the possibility of gain or loss should he decide to tender plan-held shares.⁵¹ The trustee must independently evaluate the adequacy of the offered price.⁵² He must consider current sponsor dividend policy and determine the potential for future increases in stock value. If the bidder offers stock or other securities, the trustee

common law rules—the tension between the investment goals of the income beneficiary and the remaindermen—need not be faced by pension plan fiduciaries”).

45. See, e.g., *Winpisinger v. Aurora Corp. of Ill.*, 456 F. Supp. 1455, 1466 (N.D. Ohio 1978) (“a fiduciary is forbidden from granting preference as between plan’s participants or as between plan’s beneficiaries”).

46. Trustees may violate fiduciary standards by exhausting plan assets through payments to a single class of beneficiaries. See *Withers v. Teachers’ Retirement Sys.*, 447 F. Supp. 1248, 1257 (S.D.N.Y. 1978). See also *Streeter v. Bd. of Trustees of Const. Laborers Pension Trust*, 435 F. Supp. 1168, 1171 (C.D. Cal. 1977) (preservation of actuarial soundness can serve as a basis for establishing eligibility standards), *aff’d*, 586 F.2d 148 (9th Cir. 1977); *Morse v. Stanley*, 566 F. Supp. 1455, 1459 (S.D.N.Y. 1983) (denial of accelerated payments justified as preventing trust dissipation).

47. At retirement, the benefit level generally is not subject to change. See *supra* notes 16 & 18. An employee’s right to 100% of his accrued benefit must be nonforfeitable upon reaching normal retirement age. ERISA 203(a), 29 U.S.C. § 1053(a) (1982). This is true without regard to the vesting schedule employed. See *supra* note 13 and accompanying text. Thus, even benefits payable under a defined contribution plan generally will not be affected by current investment income.

48. See *infra* notes 51-53 and accompanying text.

49. See *infra* notes 54-73 and accompanying text.

50. See *infra* notes 74-91 and accompanying text.

51. Labor regulations interpreting ERISA’s fiduciary standards require the trustee to consider the possibility of investment gain or loss. See 29 C.F.R. § 2550.404a-1(b)(2) (1985). Cf. A. SCOTT, *supra* note 20, at § 231 (trustees may have a duty to sell if asset values rise and retention is imprudent).

52. See Note, *Trustee Duties*, *supra* note 30, at 1713. Inside information may also support a finding that the offered price is inadequate. *Id.* at 1717 n.89.

must evaluate the strength of such assets relative to current holdings.⁵³ In short, the trustee must conduct a traditional common-law trust investment analysis.

The trustee should bear in mind, however, the unique role that sponsor stock plays as a plan asset. Congress allowed plan investment in sponsor stock because it recognized the "symbiotic relationship" existing between an employer and the company benefit plan.⁵⁴ This relationship benefits both the employee and employer. Plan ownership of sponsor stock represents employee ownership and functions to distribute corporate wealth, improve employee production and facilitate labor relations.⁵⁵ Sponsor stock also provides limited plan protection in the form of voting rights.⁵⁶ In tendering sponsor stock, the trustee forfeits a friendly voice in corporate governance. Thus, the benefits available from plan ownership of sponsor stock militate against sale of that stock.

In addition, a trustee should consider that a successful ERISA trust strategy does not depend on significant investment return premiums. Annual employer contributions⁵⁷ lessen the need for investment income as a means to satisfy current payment obligations. Moreover, the distribution and contribution predictability of ERISA trusts reduces the re-

53. Cf. *Marshall v. Glass/Metal Ass'n & Glaziers*, 507 F. Supp. 378, 384 (D. Hawaii 1980) (committing assets without adequately evaluating the alternatives is imprudent).

54. *Private Pension Plan Reform: Hearings Before Subcomm. on Private Pension Plans of Senate Comm. on Finance*, 93d Cong., 1st Sess. 446 (1973) (statement of Labor Dept.). Common-law trust principles concerning trust holding of close corporation stock provides an analogous situation. Courts more readily find a grantor intention to prohibit a trustee from selling family stock held in trust. See A. SCOTT, *supra* note 20, at § 190.3.

55. See *Herald Co. v. Seawell*, 472 F.2d 1081 (10th Cir. 1972), where the court noted that a stock ownership plan has the effect of (1) causing greater employee pride in work, (2) reducing employee turnover, (3) pinning down key personnel at a young age, and (4) aiding in production and labor relations. *Id.* at 1096.

56. Trustees often exercise the voting rights of plan-held shares. In so doing, the trustees must act in accordance with their fiduciary duties. See *Davis & Daniel*, *supra* note 4, at 270. In *Dimond v. Retirement Plan for Emp. of Michael Baker*, 582 F. Supp. 892 (W.D. Pa. 1983), the court recognized the importance of the plan vote. The plan trustees purchased sponsor stock with voting rights vested in the employer. *Id.* at 898. The court found the trustees liable partly because the employer would "be able to block any Plan's proposal or successfully vote against any proposal which the Plan supports . . ." *Id.* See also Note, *Restraints*, *supra* note 30, at 744 (courts will look to whether voting control of ESOP shares is vested in trustees or employees as a factor in determining motivation for establishing an ESOP in the face of a tender offer).

57. ERISA § 402(b)(1), 29 U.S.C. § 1102(b)(1) (1982) requires a plan to establish a "funding policy." This provision enables the trustee to determine short and long term financial needs. See H.R. REP. NO. 1280, 93d Cong., 2d Sess. 304, reprinted in 1974 U.S. CODE CONG. & AD. NEWS 5038, 5335. See also Lamon, *supra* note 39, at 525 (noting that the funding policy directly impacts investment actions).

quirement for cash reserves.⁵⁸ These factors allow a trustee to strive for long-term growth rather than short-term premium yield.⁵⁹ A trustee should, therefore, find the tender premium less attractive than would other investors. At a minimum, the trustee should compare the offered premium with his estimation of the stock's current and potential market value rather than considering only the immediate, realizable gain.⁶⁰

A defined-benefit plan trustee also must recognize that the tender premium serves only to decrease employer contributions.⁶¹ Because only the employer benefits, the tender premium offers a less significant advantage. In addition, without regard to the type of established plan, all investment income becomes part of the plan's assets.⁶² Economic factors and overall investment policy influence the trust's performance over the course of many years. Thus, the tender premium plays an uncertain long-term role in determining ultimate employee or plan benefit.

Trustees also should consider the "promise" of a successful benefit plan when deciding whether to tender plan-held shares. Congress did not intend such plans as vehicles for maximizing participant wealth.⁶³ Rather, Congress designed employee-benefit plans to provide reasonable

58. See *Fiduciary Responsibility and the Employee Retirement Income Security Act of 1974*, 12 REAL PROP., PROB. & TRUST J., 285, 298 n.7 (noting that actuarial tables allow trustees to determine the likelihood and timing of events) [hereinafter cited as *Responsibility and ERISA*]; Note, *Risky Investments*, *supra* note 43, at 622 (noting that a young and expanding labor force decreases the trustees' need to consider liquidity). But see 29 C.F.R. § 2550.403a-1 (1985) (liquidity considerations are a part of the Dept. of Labor's investment regulations).

59. See ROTHMAN, ESTABLISHING & ADMINISTERING PENSION & PROFIT SHARING PLANS & TRUST FUNDS, 146-47 (1970). Rothman concludes that a trustee is free to invest for the long term, without giving undue attention to market fluctuations and other short-term economic considerations. *Id.* See also *Report of the Committee on Investments by Fiduciaries, Current Investment Questions and the Prudent Person Rule*, 13 REAL PROP. & TR. J. 650, 664 (1978) (noting that the price of market timing is not permitted within the prudent man rule). Cf. *Marshall v. Glass/Metal & Glazier*, 507 F. Supp. 378, 385 (D. Hawaii 1980) (possible high, short-term return does not justify risky investment). But see Note, *supra* note 18, at 968 (ERISA trustees are free to take risks a common law trustee could not).

60. See Welch, *Investment For and Management of Employment Benefit Trusts—Waiver and Modification of the Prudent Man Rule*, 110 TR. & EST. 350 (1971). Welch notes that there is no "virtue" in realized gain as compared to unrealized gain. *Id.* at 350-51. Thus, cash does not provide an advantage over appreciated stock or stock with a true value higher than the market reflects.

61. See *supra* note 18 and accompanying text.

62. See *supra* note 4.

63. Cf. *Elliot Knitwear Profit Sharing Plan v. Comm.*, 614 F.2d 347 (3d Cir. 1980) (recognizing that "investment activity is a means to accomplish the purpose of deferred compensation—it is not the purpose itself of the Plan").

post-retirement income.⁶⁴ Tendering plan-held shares may represent a trustee's misguided attempt at maximizing current trust income and participant wealth.

Finally, the trustee must consider the possibility of plan termination⁶⁵ after a successful acquisition. A defined-benefit plan termination allows the new sponsor to recapture plan funds in excess of the amounts needed to satisfy the current plan liability to participants.⁶⁶ If the sponsor plan currently contains an excess, amounts received on tender increase this excess and are subject to recapture.⁶⁷ The attractive premium thus becomes a benefit only to the new sponsor.

Thus, ERISA's focus on providing reasonable income rather than maximum yield,⁶⁸ the resulting lack of dependence on high-yield returns,⁶⁹ and the interplay of long-term economic forces on overall trust performance,⁷⁰ justify great judicial deference to a trustee's decision concerning any particular investment. These factors, coupled with the unique role of plan-held sponsor stock⁷¹ and the danger of plan termination,⁷² should persuade courts to allow trustees wide discretion in their

64. Cf. I.R.C. § 415, 26 U.S.C. § 415 (1982) (placing upper limits on the benefits receivable under a qualified plan).

65. ERISA § 4042, 29 U.S.C. § 1342 (1985) allows a sponsor to terminate a plan when the sponsor determines that any of the stated conditions exist.

66. ERISA § 4044(d)(1), 29 U.S.C. § 1344(d)(1) (1985) allows the employer to recapture "residual assets" if plan liabilities to participants are satisfied and the plan allows for recapture. See G. BOREN, *supra* note 16, at § 17:15. A decision to terminate cannot subject the employer to fiduciary liability. See, e.g., Dist. 65, U.A.W. v. Harper & Row Publishers, Inc., 576 F. Supp. 1468, 1477-78 (S.D.N.Y. 1983) (right to terminate is predicated on the voluntary nature of benefit plans).

I.R.C. § 401(a)(2), 26 U.S.C. § 401(a)(2) (1985) likewise allows recapture on plan termination. Any trust balance remaining "due to erroneous actuarial computations" after payment of liabilities is subject to recapture. Treas. Reg. § 1.401-2(b) (1985). Any surplus remaining after payment of liabilities satisfies this requirement. See Intern. Union, United Auto v. Dyneer Corp., 747 F.2d 335, 337 (6th Cir. 1984).

The amount of assets available for recovery is staggering. A threatened termination of the United Airlines plan in 1985 would have allowed recapture of \$962 million. Sheppard, *Overfunded Pension Plan Terminations: Raiding the Cookie Jar?*, TAX NOTES, June 17, 1985, at 1327. In 1984 there were 284 plan terminations resulting in at least \$1 million in asset recapture. *Id.*

67. Investment income would accumulate in the pension fund. See Welch, *supra* note 60, at 351. If the plan is overfunded, the income only would add to the surplus and would be subject to recapture.

68. See *supra* notes 63-64 and accompanying text.

69. See *supra* notes 57-60 and accompanying text.

70. See *supra* note 62 and accompanying text.

71. See *supra* notes 54-56 and accompanying text.

72. See *supra* notes 65-67 and accompanying text.

decision to tender or retain plan-held shares.⁷³

2. *Effect on Plan Participants: Protecting Expectations*

An ERISA trustee must act solely in the interest of plan participants.⁷⁴ Apart from the direct gain or loss associated with a particular investment, the trustee must consider the effect his actions will have on participant expectations. In *Eaves v. Penn*,⁷⁵ the Tenth Circuit held a plan fiduciary liable for encouraging a plan amendment that jeopardized participants' "legitimate expectations"⁷⁶ in the form and value of retirement payments.⁷⁷ Thus, in considering a tender offer, the trustee must evaluate the bidder's policy toward employee benefit plans.⁷⁸

The first option available to a successful bidder, plan termination, jeopardizes benefit expectations. ERISA contains safeguards protecting only accrued employee benefits.⁷⁹ ERISA does not protect ancillary benefits,

73. The Department of Labor's "safe harbor" provisions are consistent with an approach allowing great deference to a trustee in a tender offer. 29 C.F.R. § 2550.404a-1 (1985) provides that appropriate trustee considerations include:

- (i) A determination . . . that the particular investment . . . is reasonably designed, as part of the portfolio . . . to further the purposes of the plan, taking into consideration the risk of loss and the opportunity for gain . . . , and
- (ii) Consideration of the following factors as they relate to such portion of the portfolio:
 - (A) The composition of the portfolio with regard to diversification,
 - (B) The liquidity and current return of the portfolio relative to the anticipated cash flow requirement of the plan, and
 - (C) The projected return of the portfolio relative to the funding objectives of the plan. . . .

"Portfolio theory" focuses on the value of the portfolio as a whole as a proper test of prudence. See *Responsibility and ERISA*, *supra* note 58, at 293. Although courts generally have rejected portfolio theory, portfolio concerns are weighed in judging the prudence of a particular investment. See, e.g., *In re Bank of New York*, 35 N.Y.2d 512, 323 N.E.2d 700, 364 N.Y.S.2d 164 (1974). This Note does not advocate portfolio theory, but argues that the portfolio value of sponsor stock should influence judicial treatment of a decision to retain such shares.

74. See *supra* notes 22-25 and accompanying text.

75. 587 F.2d 453 (10th Cir. 1978).

76. *Id.* at 463.

77. In *Eaves*, the employer converted a profit sharing plan into an ESOP with the goal of having the plan purchase 97% of the stock of Glen's Inc. Penn, the plan trustee, purchased the remaining shares of Glen's Inc. *Id.* at 455. Under the new plan, distributions were made in company stock. This stock was unmarketable and the beneficiaries held no right to have the company repurchase the stock. The court noted that expectations of beneficial retirement income were jeopardized through this arrangement. *Id.* at 463.

78. *Accord Comment, Prudent Response*, *supra* note 30, at 860 (trustee should thoroughly assess the bidders' pension fund to determine how a merger or acquisition will affect the target plan).

79. An "accrued benefit" in a defined-benefit plan is a benefit in the form of an annual benefit commencing at normal retirement age or the actuarial equivalent of the same. An "accrued benefit"

such as medical and disability payments.⁸⁰ In addition, termination effectively prevents further benefit accrual in defined contribution plans⁸¹ and defined benefit plans which base benefits on years of participation.⁸² Moreover, because salary levels at the time of plan termination are likely to be lower than salary levels at retirement age, termination of a defined benefit plan may freeze employee benefits at a level below the employee's expectation.⁸³

Alternatively, a successful bidder may choose to continue the sponsor plan.⁸⁴ The trustee, however, must evaluate the terms of plans currently maintained by the bidder for evidence of the bidder's intentions.⁸⁵ The trustee must anticipate possible bidder actions toward the target's current plan. ERISA generally prohibits only retroactive plan amendments altering accrual rates and vesting schedules.⁸⁶ The employer can prospectively amend such provisions. In addition, the bidder may change future benefit levels⁸⁷ and participant options.⁸⁸ All of these actions nec-

in a defined-contribution plan is the employee's account balance. *Id.* at § 1.411(a)-7 (1985). *See supra* note 66 and accompanying text.

80. *Cf.* Treas. Reg. § 1.411(a)-7(a)(1)(ii) (1985). The definition of "accrued benefit" does not include ancillary benefits not directly related to retirement payments such as medical benefits, disability benefits, life insurance benefits payable in lump sums or current life insurance protection. *Id.*

81. Amounts credited to an employee's account at the time of plan termination must be nonforfeitable. Treas. Reg. § 1.411(d)-2(a) (1985). After termination, however, additional amounts are not contributed on the employee's behalf.

82. A defined-benefit plan may provide, for example, that for each year of participation the employee will receive a retirement benefit equal to 1% of the employee's average salary for the final 3 years of service. If termination occurs after the employee has completed 10 years of participation, his benefit percentage is effectively frozen.

83. *See* Sheppard, *supra* note 66, at 1328. Sheppard cites the example of a plan termination when an employee is age 45. The plan based benefits on a percentage of salary. Because the employee's salary is likely to be lower at age 45 than at normal retirement age, he will receive amounts less than he would have had the plan continued. *Id.*

84. A third option is plan merger. ERISA § 208, 29 U.S.C. § 1058 (1982) allows a benefit plan to merge with another if the benefit available immediately after the merger is equal to or greater than the premerger benefit. Assuming this requirement is not violated, merger with an underfunded plan will allow a tender premium to be diverted to that plan. The premium thus provides no benefit to the target plan. The trustees in *Bierwirth* recognized this danger, but the court found their fears unjustified. *Donovan v. Bierwirth*, 680 F.2d 263, 273 (2d Cir. 1982), *cert. denied*, 459 U.S. 1069 (1983).

85. *Accord* Comment, *Prudent Response*, *supra* note 30, at 860.

86. *See* ERISA § 203(c)(1), 29 U.S.C. § 1053(c)(1) (1982); I.R.C. § 411(a)(10), 26 U.S.C. § 411(a)(10) (1982) (concerning amendments to vesting schedule). *See* ERISA § 204(g), 29 U.S.C. § 1054(g) (1982); I.R.C. § 411(d)(6), 26 U.S.C. § 411(d)(6) (1982) (concerning amendments affecting accrued benefits).

87. ERISA does not mandate minimum funding levels. *See supra* note 14 and accompanying text.

essarily affect employee expectations.

Finally, the trustee must ascertain the bidder's intentions as to the target company. For plan participants, the continuation of the sponsor's business and continued employment with the sponsor provides the only means to insure continued plan participation. In *Wither v. Teachers' Retirement Systems*,⁸⁹ the court held that a trustee's investment in speculative city bonds was a prudent means to insure the city's continued viability as plan sponsor.⁹⁰ The court recognized the link between the financial health of the plan and that of the sponsor.⁹¹ Likewise, threatened cessation or reduction of the sponsor's affairs, or likely employee terminations, militate against a tender of plan-held shares. The trustee must protect the participants' expectations of continued participation.

IV. CONCLUSION

An ERISA trustee faces a difficult dilemma in responding to a tender offer. Tendering plan-held shares may be disadvantageous to the plan. The trustee must conduct a thorough and independent evaluation. He must consider the direct investment gain and loss associated with his decision. He must also determine the likely effect of tendering on the plan and participant expectations. In many instances, retention of plan-held shares may offer the best course of action. Courts should show great deference to a trustee's decision to withhold plan-held shares.

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88. Ancillary benefits are not accrued benefits subject to protection. *See supra* note 80. *See, e.g., Pierce v. NECA-IBEW Welfare Trust Fund*, 620 F.2d 589 (6th Cir. 1980), *cert. denied*, 449 U.S. 1015 (1980) (amendment reduced extended health care coverage from 6 months to 31 days).

89. 447 F. Supp. 1248 (S.D.N.Y. 1978).

90. *Id.* at 1259. *See supra* note 38.

91. *Id.* at 1256 (noting that the importance of the city's solvency lay in the city's role as major contributor to the pension fund and guarantor of future benefit payments). *Accord Note, Trustee Duties, supra* note 30, at 1696 (noting that trustee must be concerned with the financial health and history of the bidder corporation).

