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IN THE UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF ILLINOIS
PEORIA DIVISION

JACKIE LYSENGEN, on behalf of the Morton Buildings, Inc. Leveraged Employee Stock Ownership Plan, and on behalf of a class of all other persons similarly situated,

Plaintiff,

v.

ARGENT TRUST COMPANY, JAN ROUSE, and EDWARD C. MILLER

Defendants.

Case No. 1:20-cv-01177

[PROPOSED] PLAINTIFF'S SURREPLY
IN FURTHER OPPOSITION TO DEFENDANTS' MOTION TO DISMISS

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In their Reply in Support of Motion to Dismiss (Dkt. 27), Defendants improperly raise arguments for the first time that could have been raised in their Motion to Dismiss (Dkt. 17)—such as an argument against the Count I ERISA § 406(b) claim where none was asserted previously and a new argument against Count IV—and arguments that further mischaracterize the record in an unrelated case. Because all such arguments are meritless, and for the reasons set forth below and in Plaintiff's Opposition (Dkt. 22), the Court should deny the Motion.

1. <u>Defendants mischaracterize the Illinois State Case.</u>

Defendants dispute the veracity of Plaintiff's allegations and contend they lack the specificity required under Rule 9(b). But as Plaintiff previously noted, such arguments are improper at the pleadings stage when evaluating non-fraud claims. *See* Dkt. 22, Pl. Opp. to Defs. Mot. to Dismiss ("Pl. Opp."), pp.9-12. However, Defendants have now on reply thoroughly muddled the record and distorted facts in insisting that the May 2017 ESOP Transaction described in Plaintiff's Complaint was thoroughly reviewed and addressed in a November 2016 state court decision (the "Illinois State Case"). The reality of the Illinois State Case is:

- The complaint therein was filed in December 2015 by a minority shareholder in Morton Buildings, Inc. ("Morton") challenging a proposed ESOP transaction under discussion in the Fall of 2015. Although the complaint originally named Argent Trust Company ("Argent") as a defendant, Argent was quickly dismissed from the case in February 2016 before answering.
- After a truncated discovery period, trial was held in October 2016. The plaintiff "flip-flopped from arguing that the Transaction price was too high, to contending it was too

low, and, finally, to abandoning any challenge to price."[1] Therefore, the plaintiff did not call any experts or witnesses to oppose the transaction or to argue the price was too high.[2] Indeed, the only witness she called was herself.[3] The court was left with a one-sided account of the 2015 process.[4]

- The court did not evaluate Argent's 2015 process under the strict lens of ERISA's fiduciary standards and did not evaluate whether it was "fair" from the Plan's perspective. Indeed, as Defendants concede, "the Plan was not a party [in the 2016 Illinois State Case] because, at the time, the transaction that created the Plan had not yet occurred." Def. Reply p.5.
- The court issued its order in November 2016 – long before the May 2017 ESOP Transaction at issue in this case and long before the relevant date of Morton's value.

There can be no serious argument that anyone in the Illinois State Case trial advocated on behalf of the Plan or challenged Argent's process *in 2017* (much less under ERISA's standards) or the price Argent agreed to pay on behalf of the Plan *in 2017*. And there can be no serious argument that the court evaluated anything beyond a process or negotiation that occurred in 2015, a year and a half before the May 2017 ESOP Transaction at issue here. Defendants' contention that a process occurring a year and a half *before* the May 2017 ESOP Transaction about which Plaintiff complains defeats Plaintiff's breach of fiduciary duty claim at the pleadings stage suggests that: it did not perform additional diligence between 2015 and May

[1] Defendant Morton Buildings, Inc.'s Proposed Findings of Fact and Applicable Law, attached as Exhibit A, p.2.
[2] *Id*., p.1.
[3] *Id*.
[4] The disarray and lack of coherent strategy is also suggested in the fact that the plaintiff retained new counsel on the eve of trial.

2017; it relied on the stale information used to “negotiate” in late 2015 to approve the Plan’s purchase in May 2017; and no additional negotiations took place in that year and a half. If that’s the case, Argent has conceded it breached its fiduciary duties to the Plan. And aside from the issue of due diligence, fair market value is at issue in the ERISA § 408(e) “adequate consideration” affirmative defense, and no court has considered expert opinion and decided the fair market value of Morton stock as of the May 2017 transaction date. In sum, there can be no dispute that the facts, law, and parties in the Illinois State Case were different from those in this case, and therefore the Illinois court decision cannot carry Defendants’ Motion.

2. Plaintiff stated a Count I claim under 29 U.S.C. § 1106(a).

Despite Defendants’ feigned incredulity, yes, “a purchase of employer stock by the Plan and a loan by the employer to the Plan [ ] are indisputably prohibited transactions within the meaning of section 406.” *Allen v. GreatBanc Trust Co.*, 835 F.3d 670, 675 (7th Cir. 2016) (citing 29 U.S.C. § 1106(a)). That’s what the statute says. That’s what the Seventh Circuit and numerous other courts have said. *See id.*; *Zavala v. Kruse-W., Inc.*, 398 F. Supp. 3d 731, 743 (E.D. Cal. 2019); *Blackwell v. Bankers Tr. Co. of S. Dakota*, No. 3:18-CV-141, 2019 WL 1433769, at *4 (S.D. Miss. Mar. 29, 2019) (“BTC has not provided any controlling case law where courts dismissed ERISA actions because the plaintiff did not preemptively address an affirmative defense.”). Indeed, facts supporting those basic allegations enable entry of summary judgement for the plaintiff. *See Brundle v. Wilmington Tr., N.A.*, No. 1:15-CV-1494, 2016 WL 6542718, at *12 (E.D. Va. Nov. 3, 2016) (granting summary judgment for plaintiff on whether the trustee violated the prohibited transaction statute because “there is no genuine dispute that the 2013 Purchase would be a violation of § 1106(a). Wilmington, the fiduciary, caused the ESOP, a plan, to purchase stock from a party in interest, employer Constellis”); *Neil*

v. Zell, 753 F. Supp. 2d 724 (N.D. Ill. 2010) (granting plaintiffs' motion for partial summary judgment in ESOP case). Defendants concede that Plaintiff alleged those "basic elements of a prohibited transaction" (Def. Reply p.8). Therefore, the Motion to Dismiss should be denied.

The rest of Defendants' reply makes the same argument, rejected by the Seventh Circuit, that Plaintiff must plead around affirmative defenses, and that the Illinois State Case somehow proves the defense. The former point has been explicitly rejected by the Seventh Circuit. "A plaintiff alleging a claim arising out of a prohibited transaction involving an exchange of stock between a plan and a party in interest need not plead the absence of adequate consideration." *Allen*, 835 F.3d at 675; *see also Gomez v. Toledo*, 446 U.S. 635, 640 (1980) (holding burden to plead affirmative defense is defendant's and plaintiff has no obligation to anticipate a defense with statements in complaint); *Davis v. Indiana State Police*, 541 F.3d 760, 763 (7th Cir. 2008) ("Complaints need not anticipate, and attempt to plead around, potential affirmative defenses.").[5] And even if the adequate consideration defense was somehow implicated at the pleading stage, the Illinois State Case is not helpful (much less dispositive) on the issue. Defendants are encouraging the Court to commit plain reversible error by flaunting direct and controlling Seventh Circuit law.

[5] Defendants cite only *Scott v. Aon Hewitt Fin. Advisors, LLC*, No. 17 C 679, 2018 WL 1384300 (N.D. Ill. Mar. 19, 2018), but that decision involved a prohibited transaction under ERISA § 406(a)(1)(C), which is not at issue here; the affirmative defense at issue was the § 408(b)(2) defense and not the § 408(e) defense at issue here; and that was not a private company ESOP case. The Seventh Circuit's *Allen* decision, which is on all fours with this lawsuit, is therefore the one that is relevant here, and because *Scott* is distinguishable it cannot be said to contradict *Allen* or Plaintiff's arguments on her pleading obligation. Moreover, *Scott* has never been cited by another court and is contrary to *Allen* and every court to consider the issue since.

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3. <u>Plaintiff stated a Count IV claim under 29 U.S.C. § 1132(a)(3).</u>

Defendants' motion to dismiss does not make any argument for a unique pleading standard applying to the Count IV claim against the individual Defendants, and never even mentions 29 U.S.C. § 1132(a)(3). Defendants' raising of new grounds for dismissal in their Reply (pp. 8-9) is improper "sandbagging" and the arguments should not be considered by the Court. *See Hussein v. Oshkosh Motor Truck Co.*, 816 F.2d 348, 360 (7th Cir. 1987) (Posner, J., concurring) ("A reply brief is for replying, not for raising a new ground"); *United States v. Dish Network, LLC*, No. 09-3073, 2015 WL 4635012, at *5 (C.D. Ill. Aug. 4, 2015) ("Raising new matters in a reply is improper."); *Caster Connection, Inc. v. Colson Grp. Holdings, LLC*, No. 20 C 1598, 2020 WL 2745982, at *2 (N.D. Ill. May 27, 2020) (citations omitted) ("[I]t is beyond peradventure that it is improper to sandbag one's opponent by raising new matter in reply.").

Even if the Court were to consider Defendants' new argument, it lacks merit. Defendants concede Plaintiff alleged the elements of a prohibited transaction against Argent. *See* Def. Reply at 8. To state a claim against the Selling Shareholders, the only additional requirement is that they have knowledge of the elements that make up a prohibited transaction. Plaintiff alleged so. *See* Pl. Opp. at 3-4. And yet Defendants again try to foist an additional pleading hurdle on Plaintiff and argue that she must also establish that the transaction was "unlawful" by pleading the absence of an affirmative defense. But the prohibited transaction *is* the "unlawful" (*i.e.* prohibited) transaction. *See Allen*, 835 F.3d at 674-677. As this Court has noted at the summary judgment stage, "once Plaintiffs establish the purchase of stock by the ESOP constituted a prohibited transaction under §406, § 502(a)(3) then provides a right of action to seek appropriate equitable relief from parties-in-interest to redress the violation." *Keach v. U.S. Trust Co., N.A.*,

244 F. Supp. 2d 968, 975 (C.D. Ill. 2003). The defendants can then invoke their affirmative defenses. *Id*. The Selling Shareholders are on notice of the claim against them and can assert affirmative defenses at the appropriate time. The Motion to Dismiss Count IV should be denied.

4. Defendants did not file a complete version of Morton's "revised" Form 5500.

Defendants complain that Plaintiff "wrongly accuse[d]" them of "withholding" documents from the Court. Def. Reply at 5-6. Stripped of pearl-clutching, here are the facts:

In October of 2017, Morton filed a publicly-available Form 5500 that reflected a share value of $58.04 as of December 31, 2016. Plaintiff referenced that document and the share price that Morton submitted to the DOL and IRS in the Complaint. Compl. ¶ 52.

Morton "corrected" its December 31, 2016, value a year later, on November 21, 2018 in a revised Form 5500. Defendants filed *part of the revised* Form 5500 as Exhibit C to their Motion to Dismiss. However, as Plaintiff pointed out in its Opposition, Defendants *did not include* in that Exhibit C the *complete* Supplemental Schedule, signed on November 21, 2018, that follows the Notes to Financial Statements of the filing. *See* Pl. Opp. p.16; 2016 Form 5500 (Dkt. 22-1) at pp. 40-43 of 43 (filed Nov. 21, 2018) (reporting different Morton stock value than the Schedule H, Line 1d(1), in the same amended Form 5500). Defendants can quibble the word "withheld" but there is no question the complete supplemental schedule was not included in Defendants' Exhibit C but was included by Plaintiff as Exhibit A to her Opposition. Plaintiff sought to give the Court a complete and accurate picture of the varying values Morton submitted to the government. The complete supplement schedule, including the page missing from Defendants' Exhibit C is again included here as Exhibit B.

5. <u>Plaintiff stated Count I claims under 29 U.S.C. § 1106(b).</u>

Defendants make no argument against the Count I ERISA § 406(b) claims in their Motion to Dismiss. Defendants' raising of new grounds for dismissal in their Reply is improper for the reasons stated above. Even if the Court were to consider Defendants' dilatory arguments, they lack merit and the Motion should be denied.

To state a § 406(b)(2) prohibited transaction claim against Argent, Plaintiff needs to allege facts sufficient to make it plausible that Argent acted in the ESOP Transaction on behalf of the counterparties to the Plan, the Selling Shareholders. Plaintiff did so. See Compl. ¶¶ 7, 53-54, 74. Plaintiff details throughout the Complaint how Argent allowed the Selling Shareholders to receive more than fair market value for their shares. Regardless of what Argent's engagement agreement says it *should have* done on behalf of the Plan, Plaintiff alleges that it *in fact* failed to do so.

To state an ERISA § 406(b)(3) prohibited transaction claim against Argent, Plaintiff needs to allege facts sufficient to make it plausible that Argent received consideration for its own personal account from Morton, which dealt with the Plan as lender in ESOP Transaction. Plaintiff did so. Compl. ¶¶ 5, 45, 57-58, 61, 75. Defendant does not dispute that but argues that no prohibited transaction occurred because (1) Argent was not acting as a fiduciary when it negotiated its pay and (2) its fees were not unreasonable. Def. Reply p.10. The first argument is a red herring. This is a prohibited transaction claim, not a breach of fiduciary duty claim. Therefore Argent's statutory breach was not at the time of negotiation, but rather it faces liability *per se* for its receipt of the prohibited consideration, and there can be no dispute that Argent was a fiduciary when it was paid for having completed its Trustee services in the ESOP Transaction. The second argument is but another example of Defendants pointing to an affirmative defense

that Plaintiff is under no obligation to plead around. *See*, *e.g.*, *Allen*, 835 F.3d at 676 ("fundamentally, an ERISA plaintiff need not plead the absence of exemptions to prohibited transactions."). Perhaps more importantly, the reasonable compensation affirmative defense Defendants would raise does not even apply to § 406(b) claims, but only to § 406(a) claims. *See McMaken v. GreatBanc Tr. Co.*, No. 17-CV-04983, 2019 WL 1468157, at *4 (N.D. Ill. Apr. 3, 2019) (citing *Hi-Lex Controls, Inc. v. Blue Cross Blue Shield of Mich.*, 751 F.3d 740, 750 (6th Cir. 2014)); *Chao v. Linder*, 421 F. Supp. 2d 1129, 1134-36 (N.D. Ill. 2006). Plaintiff cannot have violated a pleading burden by not pleading around an affirmative defense that does not apply to her claim as a matter of law.

Courts have denied motions to dismiss § 406(b) claims based on essentially the same allegations that Plaintiff makes here. *See Blackwell v. Bankers Tr. Co. of S. Dakota*, No. 3:18-CV-141, 2019 WL 1433769, at *5 (S.D. Miss. Mar. 29, 2019); *Swain v. Wilmington Tr., N.A.*, No. CV 17-71, 2018 WL 934598, at *6 (D. Del. Feb. 16, 2018). This Court should likewise hold that Plaintiff stated claims under §§ 406(b)(2) and 406(b)(3).

6. Plaintiff stated Count III claims under 29 U.S.C. §§ 1110 and 1104.

Morton agreed to indemnify Argent for its actions as trustee. The only exceptions to that agreement are for (1) breach of fiduciary duty; (2) gross negligence or (3) willful misconduct. (Dkt. 18-1, ¶ 6; Dkt. 18-2, ¶ 9.5). Despite Defendants' claim to the contrary, nowhere does the indemnification agreement state that prohibited transaction claims are carved out. Although Defendants claim that prohibited transaction claims are a species of breach of fiduciary claims, the statute says otherwise. They occupy distinct sections of ERISA, Sections 404 and 406. 29 U.S.C. § 1104, 1106. As a sister court explained, "the point of imposing *per se* liability for ERISA § 406 prohibited transactions is that they are violations even when they are not

necessarily a material departure from ordinary standards of care." *McMaken*, 2019 WL 1468157, at *4 (discussing an indemnification agreement that did not explicitly include § 406 claims and noting "the language on its face does not unambiguously exclude indemnification for final judgments based on violations with no scienter requirement"); *see also Woznicki v. Raydon Corp.*, No. 618CV2090, 2019 WL 5702728, at *5 (M.D. Fla. Nov. 4, 2019) ("Because § 406 imposes liability on a fiduciary for violations and because § 410 prohibits provisions that 'relieve a fiduciary from responsibility or liability for *any* responsibility, obligation, or duty under' ERISA, the provision at least facially runs afoul of § 410.").[6] As in *McMaken*, "the indemnification provision is susceptible to a reading under which [the trustee] could seek indemnification for a *per se* [§ 406] ERISA violation." *Id.*[7]

And when Argent does seek indemnification for the prohibited transaction claim, the money would functionally come from the Plan and its participants. Defendants oversimplify the issue in stating the funds would come from Morton. That argument obscures that Morton is

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[6] The court continued:

> ERISA § 406 "supplements an ERISA fiduciary's general duties of loyalty and prudence to the plan's beneficiaries, as set forth in" ERISA § 404. *Keach v. U.S. Trust Co.*, 419 F.3d 626, 635 (7th Cir. 2005). And ERISA § 404(a) explicitly sets out the standard of care. If ERISA § 404(a)'s standard of care reached the conduct prohibited under ERISA § 406, then there would have been no need supplement ERISA § 404 to categorically bar certain transactions. It follows that at least some transactions prohibited under ERISA § 406 would not be a material departure from the ordinary standard of care.

Id.

[7] Defendants try to distinguish *McMaken* by claiming the indemnification agreement at issue in that case indemnified the trustee for § 406 violations. However, the court in *McMaken first* found that the primary indemnification clause (Section 15) did not include a carve-out for § 406 claims. *McMaken*, at •3-4. It was only in further support of its conclusion denying dismissal that the Court noted a subsequent section (Section 18) that seemed to eliminate any carve-outs that had been initially granted in Section 15. *Id.* at •4. Just like the indemnification here, Section 15 included exceptions for willful misconduct, negligence and departures from the standard of care. *Id.* at •3.

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100% employee owned. It is the Plan—as the sole shareholder of Morton—that is ultimately responsible to pay Argent's indemnification. In those circumstances, courts both within and outside this Circuit have concluded such an indemnification is impermissible. As a court in this Circuit recently noted, "Several courts have agreed that where an employee stock ownership program owns a significant portion of the plan sponsor's stock, indemnification of a plan fiduciary by the plan sponsor indirectly imposes the burden of the trustee's breach of fiduciary duty on the employee stock ownership program itself. *McMaken*, 2019 WL 1468157, at *6 (collecting cases). The court in *McMaken* "agree[d] with the majority." *Id*. More than a "smattering," this is the majority view.[8]

Dated: September 28, 2020

Respectfully submitted,

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[8] Defendants claim there is "precedent" in the Seventh Circuit to the contrary but the only Seventh Circuit case they cite is *Packer Eng'g, Inc. v. Kratville*, 965 F.2d 174, 175 (7th Cir. 1992). Plaintiff addresses that decision previously (Opp'n at 20 n.8) but it bears repeating that *Packer* did not involve a 100% ESOP owned company, did not involve an ESOP, and prohibited transaction claims were not at issue. And *Appvion, Inc. Ret. Sav. & Employee Stock Ownership Plan by & through Lyon v. Buth*, No. 18-C-1861, 2020 WL 4284150, at *22 (E.D. Wis. July 27, 2020), failed to grapple with the majority view or even discuss why 100% ESOP-owned companies raise a host of distinct concerns.

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CERTIFICATE OF SERVICE

I certify that on September 28, 2020, a true and correct copy of the foregoing document was filed with the Clerk of Court using the CM/ECF system, which will send electronic notification of such filing to all counsel of record.

/s/ Patrick Muench

CERTIFICATION

Pursuant to L.R. 7.1(B)(4), the undersigned attorney certifies that the foregoing memorandum does not contain more than 3,500 words, inclusive of all headings, footnotes, and quotations.

/s/ Patrick Muench