

Latest Developments in the Tribune Case - - Federal District Court Issues Mixed Bag of Rulings On Defendants' Motions to Dismiss

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On December 17, 2009, Judge Rebecca R. Pallmeyer issued Memorandum Opinion and Order No. 08 C 6833 (N.D. Ill. 2009) in the case of *Neil v. Zell, et. al.*, granting in part and denying in part motions to dismiss made by various defendants in the continuing litigation over the Tribune Company's ESOP transaction.

Background

The Parties. The plaintiffs in the case are Dan Neil and other current and former employees of Tribune Company, seeking to represent a class of participants in the Tribune ESOP. The defendants are GreatBanc (the trustee of the ESOP), members of the committee that oversaw the ESOP (the Employee Benefits Committee or EBC), members of the board of directors of Tribune Company and Samuel Zell, who was the architect of the going-private transaction.

The Transaction. The Tribune deal consisted of several parts, all of which were agreed to on April 1, 2007. The following summary is of the factual background includes only those facts that are key to the District Court's decision.

The ESOP Purchase. Tribune Company appointed GreatBanc as trustee of the ESOP on February 7, 2007. On April 1, 2007, the ESOP acquired 8,928,571 newly issued shares of common stock of Tribune Company for \$28 per share. The ESOP paid for the shares with a \$250 million promissory note to be paid

over thirty years. As a condition of the sale, the ESOP was prohibited from reselling its shares. At the time, Tribune's publicly traded common stock was trading at \$32.81 a share. The trustee received an opinion from Duff & Phelps that the terms of the purchase transaction were "fair and reasonable to the ESOP from a financial point of view."

EGI-TRB Investment in Tribune Company. EGI-TRB was an entity controlled by Zell. Also on April 1, 2007, it invested \$250 million in the Tribune Company by purchasing 1,470,588 newly issued common shares at \$34 per share (for a total purchase of \$50 million) and lending it \$200 million.

At this time, the parties also agreed to an Investor Rights Agreement pursuant to which the ESOP agreed to vote its shares in favor of the appointment of Zell and two individuals of his choosing to the board of directors. Zell was appointed to the Tribune Company board on May 9, 2007. In a separate agreement, Tribune Company's largest shareholders, the Chandler Trusts, also agreed to vote in favor of the deal (the "Chandler Voting Agreement").

Tribune Company Tender Offer. Beginning on April 25, 2007, in the next stage of the transaction, Tribune Company began a tender offer to acquire 126 million shares of its publicly traded stock at \$34 per share. The tender offer was successful, but it saddled Tribune Company with \$4.284 billion in debt.

Merger. The final step of the transaction is described by the Court as being a merger of Tribune Company with the ESOP. In any event, in the merger, Tribune Company borrowed another \$4 billion to retire 118 million shares (at \$34 per share), including the shares owned by Zell's entity, and to repay EGI-TRB's \$200 million note. As part of the transaction, however, Zell loaned an additional \$225 million to Tribune Company and paid it another \$90 million for a warrant allowing him, after ten years, to purchase 40% of Tribune Company for \$500 million. After this merger, Tribune's total outstanding debt was \$12.8 billion.

Plaintiffs' Claims Generally

The District Court characterized the plaintiffs' claims as being: (1) that every defendant except for EGI-TRB breached fiduciary duties to the ESOP either by agreeing to the deal, by failing to stop it or by failing to remedy the damages caused by the deal; and (2) that the deal was comprised of five separate transactions that were prohibited transactions under ERISA §406(a). The defendants brought motions to dismiss. In order to survive the motion to dismiss, according to the District Court, the plaintiffs must provide enough facts "to raise a right to relief above the speculative level."

Breach of Fiduciary Duty Claims

GreatBanc. The District Court ruled that the plaintiffs' complaint against GreatBanc survived the motion to dismiss. GreatBanc argued that as a matter of law it had acted prudently because the ESOP paid a price that was significantly lower than the market price (\$28 per share in the deal versus \$32.81 per share on the NYSE that day). The court stated as a matter of law that although a purchase might be permitted under ERISA §408(e) because it is below the market price of the stock, the same purchase is not automatically deemed a prudent decision under ERISA §404.

The District Court also ruled that the opinion letters from Duff & Phelps were not sufficient to allow GreatBanc's motion to dismiss, citing the well worn concept that "an independent appraisal is

not a magic wand that fiduciaries may simply waive over a transaction to ensure that their responsibilities are fulfilled.”

The defendants also argued that the plaintiffs failed to allege sufficient facts in their complaint against GreatBanc. Plaintiffs alleged, among other items, that the deal saddled Tribune Company with so much debt that the company was unlikely to succeed, that GreatBanc failed to ensure that the expert advice it sought was reasonable and that it failed to conduct its own thorough review of the transaction. The court observed that plaintiffs’ allegations raised serious questions about whether GreatBanc adequately considered the risk created by the enormous amount of debt undertaken by Tribune Company in the deal.

Sam Zell and EGI-TRB. The District Court concluded that Zell and EGI-TRB could not be held liable as fiduciaries of the ESOP and dismissed this direct claim against them. The court’s reasoning was relatively straightforward - - Zell was negotiating with the ESOP and could not have been a fiduciary until after he became a board member on May 9, 2007. The court, however, concluded that the plaintiffs did state a claim against Zell and EGI-TRB for knowingly participating in a GreatBanc’s fiduciary breach. The court noted that determining what, if any, equitable relief may be available against them would be complicated.

Board of Directors and EBC. The court first determined that members of the board of directors were not liable for a fiduciary breach because the board appointed GreatBanc as independent trustee and thereby removed itself from direct responsibility for the ESOP’s actions. The plaintiffs next argued, however, that even if the board members were not responsible for direct fiduciary actions, they breached their duty of oversight over GreatBanc and the EBC. The court dismissed this claim as well, concluding that the plaintiffs simply did not state enough facts to demonstrate the plausibility of their claims. The court similarly determined that the plaintiffs’ claims against the EBC could not with-

stand the motion to dismiss because the EBC correctly delegated all its powers to control the purchase, sale or voting of company stock to GreatBanc.

Prohibited Transaction Claims

The plaintiffs alleged that the following five transactions were prohibited transactions under ERISA §406(a): (1) the ESOP’s direct purchase from Tribune Company; (2) Tribune Company’s purchase of stock from Zell and certain directors at the time of the merger; (3) Tribune Company’s purchase of stock in the tender offer; (4) the Investor Rights Agreement; and (5) the Chandler Voting Agreement.

Initial Stock Purchase. The plaintiffs argued that the ESOP’s purchase of Tribune Company stock was a prohibited transaction because the price paid was not adequate consideration under ERISA §3(18)(A). Defendants argued that because the price paid was less than the closing price on NYSE, there was adequate consideration as a matter of law.

The court ruled against defendants’ motion because the ESOP’s shares were not registered and therefore could not be traded and because the ESOP was prohibited by agreement from reselling the shares. The court also observed that the “ESOP’s purchase price should not be directly compared to the price paid by other parties because no other party could bring to the table what the ESOP brought: an end to millions of dollars worth of corporate taxes based on the conversion from a C-corporation to an S-corporation.” Thus, the court determined that defendants’ argument that there could be no prohibited transaction as a matter of law failed, and plaintiffs should have the opportunity to develop a case that the price paid was too high.

Tribune Company’s Purchase from Zell and Others. The plaintiffs argued that Tribune Company’s purchase of stock from Zell, EGI-TRB and the Tribune directors were prohibited transactions because the ESOP should be considered an indirect purchaser of the stock, the defendants were “parties in

interest” and the \$34 paid was greater than adequate consideration. The court decided to let this claim go forward and concluded that “construing the stock purchase . . . as an indirect purchase arguably furthers the Congressional purpose of preventing parties in interest from enriching themselves in a going-private transaction.”

Tribune Company’s Purchase in the Tender Offer. The court decided similarly that the tender offer was indirectly a purchase by the ESOP and therefore survived the motion to dismiss because the plaintiffs alleged enough facts.

The Investor Rights Agreement. The plaintiffs argued that the Investor Rights Agreement was a prohibited transaction because it constituted the use of a plan asset, *i.e.*, the right to vote the stock, for Zell, a party in interest. The court weighed a 1998 Sixth Circuit ruling that the right to vote stock was not a plan asset for prohibited transaction purposes against two earlier district court cases that went the other way, and found the lower court cases more convincing. Stating that voting constitutes management or use of plan assets, the court determined that plaintiffs stated a claim that GreatBanc breached its fiduciary duties in agreeing to the Investor Rights Agreement and that Zell and EGI-TRB knowingly participated in an ERISA breach.

The Voting Agreement with the Chandler Trusts. The court dismissed plaintiff’s complaint that the voting agreement between the Chandler Trusts and Tribune Company was a prohibited transaction.

Lessons from the Case

It is important to recognize that this opinion arises from a motion to dismiss and that the court was not making any significant substantive decisions. It is not necessarily surprising that most of plaintiffs’ claims survived the motion given the low threshold plaintiffs have to meet under motions practice.

Three points in the opinion, however, bear consideration by ESOP trustees and their advisors. The first is that trustees should separately consider the question

of whether the company can survive under reasonable economic conditions when it takes on significant debt to finance an ESOP purchase of a substantial percentage of a company's stock (and document their findings). Just getting a fairness opinion may not be enough. Second, consideration should be given to whether the facts and circumstances surrounding a corporate redemption might cause the redemption to be viewed as an indirect transaction with the ESOP that might violate the prohibited transaction rules. The trustee and the seller should consider whether the redemption transaction could pass a prohibited transaction screen if the purchase were made directly by the ESOP. Finally, this is another case holding that voting rights are plan assets. ESOP transactions often involve agreements relating to voting and these agreements should be reviewed in light of the potential prohibited transaction concern.

The author of the Legal Update is a members of The ESOP Association's Advisory Committee on Legislative and Regulatory Issues. The author reviewed this article with Committee Chair, Laurence A. Goldberg, Sheppard, Mullin, Richter & Hampton, San Francisco, CA.