UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WISCONSIN

CAROL CHESEMORE, DANIEL DONKLE, THOMAS GIECK, MARTIN ROBBINS, and NANNETTE STOFLET, on behalf of themselves, Individually, and on Behalf of All Others Similarly Situated,

Plaintiffs,

v.

ALLIANCE HOLDINGS, INC., DAVID B. FENKELL, A.H.I., INC., AH TRANSITION CORP., PAMELA KLUTE, JAMES MASTRANGELO, STEPHEN W. PAGELOW, JEFFREY A. SEEFELDT, ALPHA INVESTMENT CONSULTING GROUP, LLC, and JOHN MICHAEL MAIER

Defendants,

and

TRACHTE BUILDING SYSTEMS, INC. EMPLOYEE STOCK OWNERSHIP PLAN and ALLIANCE HOLDINGS, INC. EMPLOYEE STOCK OWNERSHIP PLAN,

Nominal Defendants.

Case No. 09-CV-00413

Judge William M. Conley

Magistrate Judge Stephen L. Crocker

PLAINTIFFS' MEMORANDUM ON REMEDIES & RELIEF

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES iii

I. INTRODUCTION 1

II. REMEDIES GENERALLY AVAILABLE UNDER ERISA 3

A. The Remedies Against Fiduciaries For Breaches Of Their Fiduciary Obligations Under ERISA §§ 404 And 406 3

B. The Remedies Against Non-Fiduciaries 4

1. Liability Of A Party In Interest Who Participated In A Transaction Prohibited By ERISA § 406........ 4

2. Liability Of A Non-fiduciary Who Knowingly Participates In A Fiduciary Breach........ 4

3. Remedies Against Non-Fiduciaries 6

III. GUIDING PRINCIPLES REGARDING THE APPLICATION OF THE REMEDIES UNDER ERISA 7

IV. MEASURING THE LOSSES RESULTING FROM ERISA VIOLATIONS 10

A. The Difference Between What The Plan Earned And What A Prudent Investment Would Have Earned 10

B. Difference Between The Price Paid And Fair Market Value 11

C. Difference Between Price Paid And Current Market Value........ 12

D. The Total Payments Made On The ESOP Loan 13

V. OTHER REMEDIES AVAILABLE UNDER ERISA §§ 409(a) And 502(a)(3)........ 13

A. Rescission 13

B. Restitution Of Profits Made By A Fiduciary 14

C. Removal & Permanent Injunction Barring Service As A Fiduciary........ 15

D. Equitable Restitution Or Disgorgement Of Ill-Gotten Gains 16

E. Accounting For Profits........ 17

F. Prejudgment Interest 18

VI. THE REMEDIES AGAINST THESE DEFENDANTS........ 18

A. The Potential Fiduciary Liability Under § 409(a) Of ERISA Of Alpha And The Trustees Of The Trachte ESOP 18

1. Rescission Of The 2007 Transaction “To The Extent Possible” 19

TABLE OF CONTENTS
(continued)

Page

2. Direct The Trachte ESOP Fiduciaries To Restore The Losses To The Trachte ESOP Resulting From The Breach 20
   a. Difference Between Price Paid And Current Market Value Of Trachte Stock 20
   b. Difference Between The Price Paid And Fair Market Value As Of The Date Of The 2007 Transaction 22
   c. The Total Payments Made By The Trachte ESOP 23
   d. The Difference Between What The Plan Earned And What A Prudent Investment Would Have Earned 23
3. Removal Of & Injunctions Against The Trachte ESOP Fiduciaries 24

B. Remedies Under ERISA § 409(a) As To Fenkell And Alliance As Fiduciaries Of The Alliance ESOP 25
1. Restoration Of The Losses Suffered In The Accounts Of The Trachte Employees In The Alliance ESOP 25
2. Disgorgement Of The Profits Made Through The Use Of The Assets In The Accounts Of The Trachte Employees In The Alliance ESOP 26
3. Rescission 27
4. Removal Of Fenkell As A Trustee Of The Alliance ESOP 27

C. Remedies Against The Alliance Defendants As Non-Fiduciaries Under ERISA § 502(A)(3) 28
1. Rescission Of The 2007 Transaction 29
2. Equitable Restitution Or Disgorgement Of Ill-Gotten Gains 29
   a. Alliance 29
   b. Fenkell 32
3. Accounting For Profits 32

CONCLUSION 33

TABLE OF AUTHORITIES

Page(s)

CASES

Baizer v. Comm'r,
204 F.3d 1231 (9th Cir. 2000) 14

Beck v. Levering,
947 F.2d 639 (2d Cir. 1991)..15

Bombardier Aerospace Emp. Welfare Benefits Plan v. Ferrer, Poirot & Wansbrough,
354 F.3d 348 (5th Cir. 2003) 5

Brown & Williamson Tobacco Corp. v. First Nat'l Bank of Blue Island,
504 F.2d 998 (7th Cir. 1974) 31

Chao v. Current Dev. Corp.,
No. 30 C 1792, 2007 U.S. Dist. LEXIS 89007 (N.D. Ill. Nov. 30, 2007)...............................18

Chao v. Hall Holding Co.,
285 F.3d 415 (6th Cir. 2002) 7, 11, 13

Chao v. Malkani,
452 F.3d 290 (4th Cir. 2006) 15

Chao v. Merino,
452 F.3d 174 (2d Cir. 2006)..16

Chesemore v. Alliance Holdings, Inc.,
276 F.R.D. 506 (W.D. Wis. 2011)..1

Chesemore v. Alliance Holdings, Inc.,
770 F. Supp. 2d 950 (W.D. Wis. 2011) 29

CIGNA Corp. v. Amara,
131 S. Ct. 1866 (2011)...6

Concha v. London,
62 F.3d 1493 (9th Cir. 1995) 4

Donovan v. Bierwirth,
754 F.2d 1049 (2d Cir. 1985)...7, 8, 10, 11

Donovan v. Cunningham,
716 F.2d 1455 (5th Cir. 1983) 13

Page

Donovan v. Estate of Fitzsimmons,
778 F.2d 298 (7th Cir. 1985) 7

Donovan v. Mazzola,
716 F.2d 1226 (9th Cir. 1983) 8

Eaves v. Penn,
426 F. Supp. 830 (W.D. Okla. 1976)..14

Eaves v. Penn,
587 F.2d 453 (10th Cir. 1978) .... passim

Eyler v. Comm'r,
88 F.3d 445 (7th Cir. 1996) 14

Free v. Briody,
732 F.2d 1331 (7th Cir. 1984) 7, 18

Freund v. Marshall & Ilsley Bank,
485 F. Supp. 629 (W.D. Wis. 1979) 5, 15

Fritcher v. Health Care Serv. Corp.,
301 F.3d 811 (7th Cir. 2002) 18

Great-West Life & Annuity Ins. Co. v. Knudson,
534 U.S. 204 (2002)..6, 17

Harris Trust & Savings Bank v. Salomon Smith Barney,
530 U.S. 238 (2000)...4, 5, 7

Henry v. Champlain Enters.,
445 F.3d 610 (2d Cir. 2006)...13

Henry v. U.S. Trust Co.,
569 F.3d 96 (2d Cir. 2009)...10

Herman v. S.C. Nat'l Bank,
140 F.3d 1413 (11th Cir. 1998) 6

Horn v. McQueen,
215 F. Supp. 2d 867 (W.D. Ky. 2002)...11

Keach v. U.S. Trust Co.,
419 F.3d 626 (7th Cir. 2005) 8

Kerr v. Charles F. Vatterott & Co.,
184 F.3d 938 (8th Cir. 1999) 17

Page

Kim v. Fujikawa,
871 F.2d 1427 (9th Cir. 1989) 9

Landwehr v. DuPree,
72 F.3d 726 (9th Cir. 1995) 32

LeBlanc v. Cahill,
153 F.3d 134 (4th Cir. 1998) 4

Leigh v. Engle,
727 F. 2d 113 (7th Cir 1984) 8, 9, 14, 30

Lowen v. Asset Tower Mgmt,
829 F.2d 1209 (2d Cir. 1987)....................6, 8

Martin v. Feilen,
965 F.2d 660 (8th Cir. 1992) 8, 16

McDannold v. Star Bank, N.A.,
261 F.3d 478 (6th Cir. 2001) 5, 7

McDougall v. Donovan,
539 F. Supp. 596 (N.D. Ill. 1982)....................14

Mertens v. Hewitt Assocs.,
508 U.S. 248 (1993)....................7, 14

Mohler v. Unger,
1994 U.S. Dist. LEXIS 21697 (S.D. Ohio Aug. 26, 1994)....................12

Moore v. CapitalCare, Inc.,
461 F.3d 1 (D.C. Cir. 2006)....................17

Neil v. Zell,
677 F. Supp. 2d 1010 (N.D. Ill. 2011) 5, 6

Neil v. Zell,
767 F. Supp. 2d 933 (N.D. Ill. 2011) .... passim

Nieto v. Ecker,
845 F.2d 868 (9th Cir. 1988) 4

Parke v. First Reliance Standard Life Ins. Co.,
368 F.3d 999 (8th Cir. 2004) 18

Reich v. Lancaster,
843 F. Supp. 194 (N.D. Tex 1993) 16

Page

Reich v. Valley Nat'l Bank of Arizona,
837 F. Supp. 1259 (S.D.N.Y. 1993)....................10, 11, 13, 23

Roth v. Sawyer-Cleator Lumber Co.,
16 F.3d 915 (8th Cir. 1994) 8

Roth v. Sawyer-Cleator Lumber Co.,
61 F.3d 599 (8th Cir. 1995) 11, 12

Scala v. Scrufari,
479 F.3d 213 (2d Cir. 2007)....................14

SEC v. Buntrock,
No. 02 C 2180, 2004 U.S. Dist. LEXIS 9495 (N.D. Ill. May 25, 2004)....................7

Sec'y of U.S. Dept. of Labor v. Gilley,
290 F.3d 827 (6th Cir. 2002) 8

Sereboff v. Mid Atlantic Med. Servs., Inc.,
547 U.S. 356 (2006)....................16

Solis v. Cooper,
No. 1:10-cv-152, 2011 U.S. Dist. LEXIS 11903 (N.D. Ind. Feb. 4, 2011) 15

Thornton v. Evans,
692 F.2d 1064 (7th Cir. 1982) 5

Turley v. Mahan & Rowsey, Inc.,
817 F.2d 682 (10th Cir. 1987) 32

United States v. Banco Cafetero Panama¸
797 F.2d 1154 (2d Cir. 1986)....................30

United States v. $ 448,342.85¸
969 F.2d 474 (7th Cir. 1992) 29

Wal-Mart Stores, Inc. Assocs.' Health & Welfare Plan v. Wells¸
213 F.3d 398 (7th Cir. 2000) 6

WMS Gaming, Inc. v. WPC Prods. Ltd.,
542 F.3d 601 (7th Cir. 2008) 33

STATUTES

29 U.S.C. §1104....................2

29 U.S.C.§ 1106(a)(1)(A) and (D)....................2

29 U.S.C.§ 1106(b)(1) and (3) 2

Page

29 U.S.C. § 1109(a) 3

29 U.S.C. § 1132(a)(2)....................3

29 U.S.C. § 1132(a)(3)....................3

I.R.C. § 4975(a) 14

OTHER AUTHORITIES

4 A. Scott, *Scott & Ascher on Trusts* § 24.13 (4th ed. 2007)....................13

4 A. Scott, *Scott & Ascher on Trusts* § 24.7 (4th ed. 2007)....................15

4 A. Scott, *Scott & Ascher on Trusts* § 24.3.5 (4th ed. 2007)....................15

4 Austin Scott & William F. Fratcher, *The Law of Trusts* § 291.3 (4th ed. 1989) 17

1 Dan B. Dobbs, *Law of Remedies* § 4.3(1) (2d ed. 1993) 17

Restatement (Second) of Trusts § 202....................30

Restatement (Second) of Trusts § 203....................15

Restatement (Second) of Trusts § 205....................11

Restatement (Second) of Trusts § 289....................32

Restatement (Second) of Trusts § 291....................31

Restatement (Second) of Trusts § 292....................32

Restatement of Restitution § 168(1) 32

Restatement of Restitution § 209....................30

Restatement of Restitution § 210....................30

Restatement of Restitution § 211....................31

Pursuant to the Court's Orders (D.E. # 614 and # 631) dated December 2, 2011 and January 18, 2012 respectively, Plaintiffs, on behalf of themselves and the Certified Class and Subclass, hereby submit the following bench brief regarding the appropriate relief to be awarded in this litigation. Pursuant to those orders, also filed herewith are the expert report of Kevin Kreitzman, which addresses the economic losses suffered by the Trachte ESOP, the Class and the Subclass, and the report of Michael Spang, which addresses the traceability of the proceeds received by Defendants Alliance and Fenkell.

I. INTRODUCTION

The Second Amended Class Action Complaint (the "Complaint" or "Compl.") alleges multiple violations under Title I of ERISA against defendants either as fiduciaries of the Trachte Building Systems, Inc. Employee Stock Ownership Plan (the "Trachte ESOP") or Alliance Holdings Employee Stock Ownership Plan and Trust ("Alliance ESOP") (collective the "Plans") or as non-fiduciaries in connection with the 2007 Transaction which resulted in the acquisition of 100% of the outstanding shares of Trachte by the Trachte ESOP in a leverage buyout. *See Chesemore v. Alliance Holdings, Inc.*, 276 F.R.D. 506, 508 (W.D. Wis. 2011). The certified Class consists of essentially all vested participants and beneficiaries in the Trachte ESOP and a Subclass consisting essentially of the Trachte employee-participants in the Alliance ESOP who had their accounts transferred to the Trachte ESOP as part of the 2007 Transaction. *See id.* at 518.[1]

This memorandum addresses the various remedies that are available under ERISA to redress the various violations alleged in Complaint in the event the Court determines that all or

[1] Excluded from the Class and Subclass are "any fiduciary[ies] of the Trachte ESOP or Alliance ESOP during the 2007 Transaction on or about August 29, 2007 and any members of their immediate families, legal representatives, heirs, successors or assigns." *Id.*

some of the Defendants are liable in Phase I. The following is a summary of the claims against the *fiduciaries* of the Plans (the "Fiduciary Claims"):

> (1) the Trachte Trustee Defendants and/or Alpha Defendants as *fiduciaries* of the Trachte ESOP breached obligations owed to the participants of the Trachte ESOP under Sections 404 of ERISA, 29 U.S.C. §1104 (Counts VI and VIII);
>
> (2) the Trachte Trustee Defendants and/or Alpha Defendants as *fiduciaries* of the Trachte ESOP caused the Trachte ESOP to engage in prohibited transactions in violation of Sections 406(a)(1)(A) and (D) of ERISA, 29 U.S.C.§ 1106(a)(1)(A) and (D) (*see* Counts VII and IX);
>
> (3) David B. Fenkell and/or Alliance as *fiduciaries* of the Alliance ESOP breached fiduciary obligations owed to the participants of the Alliance ESOP under Sections 404 of ERISA, 29 U.S.C. §1104 (Counts II and V); and
>
> (4) Fenkell and Alliance as *fiduciaries* with respect to the Alliance ESOP engaged in and/or caused the Alliance ESOP to engage in prohibited transactions in violation of Sections 406(a)(1)(D) and 406(b)(1) and (3) of ERISA, 29 U.S.C.§ 1106(a)(1)(D) and 1106(b)(1) and (3) (*see* Counts III and IV of the Compl).[2]

The Complaint also alleges violations against defendants who are either (a) parties-in-interest who participated in prohibited transactions, or (b) knowingly participated in breaches of the fiduciaries of the Plans. Those claims are summarized as follows (the "Non-Fiduciary Claims"):

> (1) Fenkell, as a *non-fiduciary* party in interest to the Alliance Plan participated in the prohibited transactions alleged against Fenkell and/or Alliance in Counts III and IV of the SAC and is therefore liable for violation of the duties imposed by Section 502(a)(3) of ERISA (*see* Count III and IV and ¶ 299);
>
> (ii) The Alliance Defendants as *non-fiduciaries* knowingly participated in the fiduciary breaches and prohibited transactions alleged against the Trachte Trustee Defendants and Alpha in Counts IV, VII, VIII and IX and are liable for violation of the duties imposed by Section 502(a)(3) of ERISA (Count XIV and ¶ 299); and
>
> (iii) Alliance, AHI and AH Transition as *non-fiduciaries* knowingly participated in the fiduciary breaches and prohibited transactions alleged against Fenkell and/or Alliance in Counts II, III, IV, and V and are liable for violation of the duties imposed by Section 502(a)(3) of ERISA (Count XV and ¶ 299).

[2] Additionally Plaintiffs assert claims of co-fiduciary liability against fiduciaries of both Plans (*see* Counts XII and XIII).

ERISA § 502(a)(2) provides the full panoply of remedies available under trust law to redress violations and breached asserted in the Fiduciary Claims against the *fiduciaries* of the Plans. *See* 29 U.S.C. § 1132(a)(2) & 1109(a). Remedies for the Non-Fiduciary Claims are limited to equitable relief available under ERISA § 502(a)(3). *See* 29 U.S.C. § 1132(a)(3). As the Court has not yet ruled as to whether any of the Defendants breached fiduciary obligations under ERISA, the present brief discusses the potential range of remedies as to each of the categories of violations alleged by Plaintiffs. In the event the Court determines that there were multiple violations of ERISA engaged in by all or some of the Defendants, *some*, but not all, of the remedies described below may overlap or be duplicative. For example, should the Court find that both the fiduciaries of the Alliance ESOP and the Trachte ESOP breached fiduciary obligations with respect to the Alliance ESOP and the Trachte ESOP, respectively, both sets of fiduciaries would have a similar obligation under ERISA § 409(a) to make good the loss to each ESOP and/or their participants.

II. REMEDIES GENERALLY AVAILABLE UNDER ERISA

A. The Remedies Against *Fiduciaries* For Breaches Of Their Fiduciary Obligations Under ERISA §§ 404 And 406

ERISA § 502(a)(2) provides a cause of action by participants and beneficiaries of a plan to obtain relief under ERISA § 409 against *fiduciaries* to redress violations of the fiduciary duties by ERISA. 29 U.S.C. § 1132(a)(2). ERISA § 409(a) in turn imposes liability upon a breaching fiduciary to (1) restore the plan of any losses resulting from a breach of fiduciary duty, (2) disgorge profits obtained through a breach of fiduciary duty, and (3) be subject to such other equitable or remedial relief deemed appropriate by the Court, including removal of a breaching fiduciary. 29 U.S.C. § 1109(a). To the extent that the Court finds that any of the Defendants breached any of the obligations or duties imposed upon *fiduciaries* by ERISA, including ERISA

§§ 404 or 406, such Defendants are liable for all the equitable and remedial relief provided under ERISA § 409(a).

B. The Remedies Against Non-Fiduciaries

1. Liability Of A Party In Interest Who Participated In A Transaction Prohibited By ERISA § 406.

While ERISA § 406 does not specifically provide that a *non-fiduciary* party-in- interest may be liable for participation in a prohibited transaction, courts have long recognized that ERISA § 503(a)(3) "expressly grants equitable power to redress violations of ERISA; prohibited transactions plainly fall within this category." *Nieto v. Ecker*, 845 F.2d 868, 873-74 (9th Cir. 1988) (finding a non-fiduciary party-in-interest may be liable for participating in a prohibited transaction); *LeBlanc v. Cahill*, 153 F.3d 134, 152-153 (4th Cir. 1998) (reaching same conclusion and citing cases from numerous Circuits). As the Supreme Court explained in *Harris Trust*, "502(a)(3) itself imposes certain duties, and therefore . . . liability under that provision does not depend on whether ERISA's substantive provisions impose a specific duty on the party being sued." *Harris Trust & Savings Bank v. Salomon Smith Barney*, 530 U.S. 238 at 245 (2000). Even if a defendant did not act in a *fiduciary* capacity in connection the 2007 Transaction, the Court may nonetheless impose liability if the *non-fiduciary* party-in-interest who participated in a prohibited transaction with respect to that plan in violation of ERISA § 406. *See* Compl. Counts III and IV. But, if the defendant was *not a fiduciary*, but merely a party-in-interest, the available remedies would be limited to those under ERISA § 502(a)(3). *Concha v. London*, 62 F.3d 1493, 1503-4 (9th Cir. 1995).

2. Liability Of A *Non-fiduciary* Who Knowingly Participates In A Fiduciary Breach

In *Harris Trust*, the Supreme Court confirmed that a non-fiduciary who knowingly participated in a fiduciary breach could be subject to liability under ERISA § 502(a)(3). *Harris*, 530 U.S. at 245. As ERISA § 502(a)(3) has "no limit . . . on the universe of possible defendants," this section imposes liability upon non-fiduciaries without regard for whether ERISA's substantive provision impose a specific duty on the party being sued. *Id.* at 246. Following *Harris Trust,* courts considering the issue have consistently held that any person – whether or not a party in interest -- who knowingly participates in a breach of a fiduciary, may be subject to appropriate equitable relief under 502(a)(3). *E.g., McDannold v. Star Bank, N.A.*, 261 F.3d 478, 486 (6th Cir. 2001) (finding that the non-fiduciary defendant did not have to be a "party in interest" to be subject to liability pursuant to Harris Trust); *Bombardier Aerospace Emp. Welfare Benefits Plan v. Ferrer, Poirot & Wansbrough*, 354 F.3d 348, 353 (5th Cir. 2003) (same); *Neil v. Zell*, 677 F. Supp. 2d 1010, 1021-2 (N.D. Ill. 2011) (same). Even before *Harris Trust*, courts in this Circuit recognized liability by a non-fiduciary for knowingly participating in the breach of fiduciary. *See Freund v. Marshall & Ilsley Bank*, 485 F. Supp. 629, 641-642 (W.D. Wis. 1979); *see also Thornton v. Evans*, 692 F.2d 1064, 1079 (7th Cir. 1982) (holding that a "remedy lies under ERISA against non-fiduciaries who conspire with fiduciaries in breach of ERISA-imposed duties is a necessary development of the law of ERISA."). In *Freund,* the non-fiduciary selling shareholders of four affiliated companies which sponsored a plan participated in the leveraged sale of their shares of stock to a third party in a transaction which resulted in all the plan's assets being loaned back to the sponsoring companies in exchange for unsecured notes which subsequently became worthless when the buyer was adjudicated bankrupt. *Freund*, 485 F. Supp. 629, 1979 U.S. Dist LEXIS 9630 at *19-22, 31 (W.D. Wis. 1979). Applying traditional trust law principles, the *Freund* court held that because the "the non-fiduciary defendants furthered the breach and took actions which completed the breach by directly participating with the trustees in the sale transaction in which the breach occurred and by accepting the benefits of

the breach . . . [i]t can safely be said that those active in the sale either personally or through their agents . . . knowingly participated in the seller trustees' breach of trust." *Id.* at 642. The court then held that the plan was entitled to be made whole by the non-fiduciary sellers and the trustee and ordered restitution to the plan in the amount of the worthless notes along with accrued interest. *Id.* at 644. Thus, if a defendant (i.e. the Alliance Defendants)[3] knowingly participated in the breaches of the fiduciaries of the Trachte Plan, ESOP and/or the Alliance ESOP, each may be liable for other appropriate equitable under ERISA § 502(a)(3). *See Neil*, 677 F. Supp. 2d at 1021.

3. Remedies Against Non-Fiduciaries

As relief under ERISA § 502(a)(3) is confined to "other appropriate equitable relief," any remedy against a non-fiduciary party is limited to those remedies which have been "traditionally viewed as 'equitable.'" *CIGNA Corp. v. Amara*, 131 S. Ct. 1866, 1878-1879 (2011) (explaining "appropriate equitable relief" in § 502(a)(3) refers to those categories of relief that, traditionally speaking (i.e., prior to the merger of law and equity) "were typically available in equity."). Appropriate equitable remedies include:

(1) rescission, *see Herman v. S.C. Nat'l Bank*, 140 F.3d 1413, 1428 (11th Cir. 1998) *and Eaves v. Penn*, 587 F.2d 453 at 463 (10th Cir. 1978),

(2) equitable restitution in the form of a constructive trust or an equitable lien, *see Great-West Life & Annuity Ins. Co. v. Knudson*, 534 U.S. 204, 213-214 (2002), *Wal-Mart Stores, Inc. Assocs.' Health & Welfare Plan v. Wells*, 213 F.3d 398, 401 (7th Cir. 2000) (explaining that a suit to impose a constructive trust is "a classic form of equitable relief against someone (not

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[3] For purposes of simplicity, Alliance and its affiliates will be referred to as "Alliance." As the Second Circuit explained, "exacting obeisance to the corporate form is inconsistent with ERISA's remedial provisions." *Lowen v. Asset Tower Mgmt*, 829 F.2d 1209, 1220 (2d Cir. 1987) ("Parties may not use shell-game like maneuvers to shift fiduciary obligations to one legal entity while channeling profits from self-dealing to a separate legal entity under their control").

necessarily a fiduciary[)]" and "nestles comfortably" within the definition of equitable relief) *and McDannold*, 261 F.3d at 486 ("[R]ecovery against a nonfiduciary under § 503(a)(3)" includes "restitution of wrongfully obtained plan assets or profits.");

(3) an injunction, *see Mertens v. Hewitt Assocs.*, 508 U.S. 248 at 255 (1993); and

(4) an accounting for profits (disgorgement), *see Harris Trust*, 530 U.S. at 250; *SEC v. Buntrock*, No. 02 C 2180, 2004 U.S. Dist. LEXIS 9495, at *8 (N.D. Ill. May 25, 2004) ("[T]he Supreme Court has held, in the ERISA context, that disgorgement is a viable equitable remedy to recover improperly received profits").

III. GUIDING PRINCIPLES REGARDING THE APPLICATION OF THE REMEDIES UNDER ERISA

"Congress intended to provide the courts with broad remedies for redressing the interests of participants and beneficiaries when they have been adversely affected by breaches of a fiduciary duty." *Eaves*, 587 F.2d at 462 (10th Cir. 1978) (citing S. Rep. No. 93-127, reprinted in 1974 U.S.C.C.A.N. 4838, 4871)); *Donovan v. Estate of Fitzsimmons*, 778 F.2d 298, 302 (7th Cir. 1985) ("The enforcement provisions of ERISA are intended to provide . . . participants and beneficiaries, with broad, flexible remedies to redress or prevent statutory violations."). Consequently, courts have "wide latitude in compensating the participants in an ESOP when a breach of fiduciary duty has been shown." *Chao v. Hall Holding Co.*, 285 F.3d 415, 444 (6th Cir. 2002); *Free v. Briody*, 732 F.2d 1331, 1337 (7th Cir. 1984) ("ERISA grants the courts the power to shape an award so as to make the injured plan whole . . . ."). Once it is determined that a fiduciary breach has occurred, courts should be guided by the goal "of restoring plan participants to the position in which they would have occupied but for the breach of trust." *Eaves*, 587 F.2d at 462-463 (citing Restatement (Second) of Trusts § 205(c) (1992)); *Donovan v. Bierwirth*, 754 F.2d 1049, 1056 (2d Cir. 1985) ("One appropriate remedy in cases of breach of fiduciary duty is the restoration of the trust beneficiaries to the position they would have occupied but for the breach of trust."). In formulating a remedy, courts are under "a duty to enforce the remedy which is *most advantageous to the participants* and most conducive to effectuating the purposes of the trust." *Donovan v. Mazzola*, 716 F.2d 1226, 1235 (9th Cir. 1983) (citing *Eaves,* 587 F.2d at 462) (emphasis added).

In considering remedies under ERISA, a plaintiff bears only the initial burden of proving a fiduciary breach and establishing a prima facie case of loss to the plan or ill-gotten profit to the fiduciary. *Martin v. Feilen*, 965 F.2d 660, 671-72 (8th Cir. 1992) (citing Bogert, *The Law of Trusts & Trustees* § 871 and numerous cases). "Once the plaintiff has satisfied these burdens, 'the burden of persuasion shifts to the fiduciary to prove that the loss was not caused by . . . the breach of duty.'" *Id.*; *Roth v. Sawyer-Cleator Lumber Co.*, 16 F.3d 915, 917 (8th Cir. 1994) (emphasizing that the burden is on the fiduciary to show a loss was not caused by the breach).[4] In determining the extent to which a loss resulted to a plan as a result of a breach by a fiduciary all ambiguities regarding the extent of the loss – or the apportionment of any profits from the use of plan assets -- are to be resolved against the breaching fiduciary. *Neil v. Zell,* 767 F. Supp. 2d 933 at 939 (N.D. Ill. 2011); *see Leigh v. Engle*, 727 F. 2d 113 at 138 (7th Cir 1984); *see also Sec'y of U.S. Dept. of Labor v. Gilley,* 290 F.3d 827, 830 (6th Cir. 2002) ("[T]o the extent that there is any ambiguity in determining the amount of loss in an ERISA action, the uncertainty should be resolved against the breaching fiduciary."); *Bierwirth*, 754 F.2d at 1056 ("[O]nce a

[4] Similarly, for a claim under ERISA § 406, once the Plaintiff establishes that the fiduciary caused the plan to engage in prohibited transaction between the plan and a party in interest, the burden shifts to the fiduciary to proving "by a preponderance of the evidence that the transaction in question fell within an exemption." *Lowen,* 829 F.2d at 1215. In this case this burden can only be met by the fiduciaries proving that no more than adequate consideration was paid for Trachte stock by the Trachte ESOP. *See Keach v. U.S. Trust Co.,* 419 F.3d 626, 636 (7th Cir. 2005) ("In order to rely on the adequate consideration exemption, a trustee or fiduciary has the burden to establish that the ESOP paid no more than fair market value for the asset, and that the fair market value was determined in good faith by the fiduciary.")

breach of trust is established, uncertainties in fixing damages will be resolved against the wrongdoer."). Where as here, the alleged violation involves a prohibited transaction under Section 406 "[i]n *determining* the amount that a breaching fiduciary must restore [to the trust] as a result of a prohibited transaction, the court 'should resolve doubts in favor of the plaintiffs.'" *Kim v. Fujikawa*, 871 F.2d 1427, 1430-1431 (9th Cir. 1989) (citing *Leigh*, 727 F.2d at 138-39) (emphasis added). "'This course avoid[s] the . . . unfair result[] of . . . depriving the plaintiffs of any recovery simply because the defendants have made it difficult to disentangle' the prohibited transaction." *Id.* at 1431.

The same principles apply where a fiduciary or other wrongdoer has profited by use of the plan's assets. *See Leigh*, 727 F.2d at 138-39 (citing 5 A. Scott, *The Law of Trusts* § 515 at 3612 (3d ed. 1967) and 1 G. Palmer, *The Law of Restitution* § 2.13 (1978)). Where a trustee has profited from a fiduciary breach and any profits attributable to the trust are comingled with the assets of the trustee, "the trustee has the burden of showing which property and profits are his. The trustee is responsible both for the difficulty and for resolving it . . .[and] while the district court may be able to make only a rough approximation, it should resolve doubts in favor of the plaintiffs." *Id.*

In determining the loss suffered by an ESOP for allegedly paying more than the fair market value of the sponsors stock, it is irrelevant that the ESOP did not pay cash but purchased the shares with promissory notes, even if it is likely that the notes will later be forgiven. As the Court explained in *Neil* even where the consideration is in the form of promissory notes "[t]he ESOP's assumption of indebtedness as part of this transaction . . . represents a real obligation, even if the ESOP's obligation is to pay money back to the lender using contributions from that same lender. . . [and] the purchases made by an ESOP necessarily represent tangible, valuable assets, not merely figures on an accounting sheet imagined to facilitate some other transaction." *Neil*, 767 F. Supp. 2d at 942. "[T]he assumption of indebtedness has immediate legal and economic consequences even before the borrower begins to repay the debt. For example, the borrower's plans for the future are now constrained by the obligation to commit future income streams to repaying the loan, and the borrower's ability to obtain future loans at a low rate decreases, because the borrower is now a greater credit risk." *Henry v. U.S. Trust Co.*, 569 F.3d 96, 99-100 n.4 (2d Cir. 2009). Likewise, in calculating the losses suffered by an ESOP in a leveraged stock purchase, the loss includes contributions made to the plan to pay down the ESOP debt as such contributions "were part of the overall benefits and compensation package offered to employees who participated in the Plan" and those "benefits are not a mere gratuity, but a form of deferred wages." *Reich v. Valley Nat'l Bank of Arizona*, 837 F. Supp. 1259, 1286-87 (S.D.N.Y. 1993) (explaining that when the ESOP's holdings in "securities are worthless, the employees have lost certain of these deferred wages.").

IV. MEASURING THE LOSSES RESULTING FROM ERISA VIOLATIONS

As there is no uniform method of measuring the losses resulting from a fiduciary breach, courts apply a number of different loss measures tailored to meet the facts of the case. *Neil*, 767 F. Supp. 2d at 944-948 (describing various methods applied by Courts to assess liability for losses resulting from breaches of fiduciary duty).

A. The Difference Between What The Plan Earned And What A Prudent Investment Would Have Earned

One appropriate measure applied to determine losses resulting from imprudent investment decisions under ERISA is set forth in *Donovan v. Bierwirth*, 754 F.2d 1049 (2d Cir. 1985). This measure of loss "requires a comparison of what the Plan actually earned on the . . . investment with what the Plan would have earned had the funds been available for other Plan purposes." *Id.* at 1056. Under this formulation, which is derived from the *Restatement (Second) of Trusts § 205* (1959), "the district court should presume that the funds would have been treated like other funds being invested during the same period in proper transactions. *Id.* "Where several alternative investment strategies were equally plausible, the court should presume that the funds would have been used in the most profitable of these. The burden of proving that the funds would have earned less than that amount is on the fiduciaries found to be in breach of their duty." *Id.*

B. Difference Between The Price Paid And Fair Market Value

Another measure of loss applied where an ESOP has paid more than adequate consideration for stock compares "the difference between the price paid and the price that should have been paid." *Valley Nat'l Bank*, 837 F. Supp. at 1289; *Hall Holding Co.*, 285 F.3d at 419-420; *Horn v. McQueen*, 215 F. Supp. 2d 867, 873-74 (W.D. Ky. 2002) ("[O]verpayment by the ESOP for employer securities constitutes a loss to the plan, measured by the difference between the purchase price paid and the fair market value of the stock at the time of the transaction."). While this "snapshot" approach may be appropriate where the breach consists solely of an overpayment by the fiduciary which has an immediate impact on the plan, it may not be appropriate in those instances where the effects of the fiduciary decision which constitute the breach are felt by the plan over a broader time frame. *Roth v. Sawyer-Cleator Lumber Co.*, 61 F.3d 599, 603 (8th Cir. 1995). In *Sawyer*, the fiduciaries imprudently secured notes with stock of a company that subsequently went bankrupt. *Id.* The court rejected the use of a "snap-shot" approach because it "failed to consider the time frame component of the loss calculation, and so doing implicitly focused upon too narrow a time frame." *Id.*; *see also Bierwirth*, 754 F.2d at 1058 ("The trial court must have discretion to fix a reasonable time at which the actual performance of the improper investment will be measured . . . .").

C. Difference Between Price Paid And Current Market Value

Another means of calculating loss is based on the difference between the total amount paid for stock acquired by the ESOP and its current fair market value. *E.g.*, *Mohler v. Unger*, 1994 U.S. Dist. LEXIS 21697 (S.D. Ohio Aug. 26, 1994). In *Mohler*, the Plaintiff's expert opined that the ESOP had overpaid for the shares of stock it acquired in a leveraged transaction; however, the court did not base its loss determination on the "snap-shot" approach. *Id.* at *29-30, *53-54. Instead, the court entered judgment in favor of the plan in an amount that represented "total purchase price paid by the ESOP" for the stock which had become worthless when the sponsor declared bankruptcy. *Id.* at *29-30, *53-54. As another court in this Circuit observed, measuring an ESOP loss in this fashion is consistent with the Restatement of Trusts which "explains that one measure of liability for a trustee in breach is '[a]ny loss or depreciation in value of the trust estate resulting from the breach of trust.'" *Neil*, 767 F. Supp. 2d at 948 (citing the Restatement (Second) of Trusts § 205(1)); *see* 4 Scott, *supra* § 24.17 (explaining that "a trustee who has improperly purchased … securities that have declined in value should be liable for the loss, even if other securities that the trustee might properly have purchased, or indeed the market as a whole, has suffered a similar or greater decline during the period").

Calculating the loss in this manner takes into account the decline in value of stock that occurs over time, which the "snapshot" approach ignores. *Sawyer-Cleator Lumber Co.*, 61 F.3d at 603 (basing the loss for a fiduciary breach on the depreciation in value of the trusts assets resulting from the breach of trust). This is particularly true in the case of a leveraged ESOP where the debt incurred in the transaction has an adverse affect on the future performance of the sponsor and the value of the sponsor's stock, which may not be fully felt immediately.

"The role of courts in reviewing the adequacy of consideration in an ERISA case is to determine whether the fiduciary can show that the price paid represented a good faith determination of the fair market value of the asset, 'not to redetermine the appropriate amount for itself *de novo*.'" *Henry v. Champlain Enters.*, 445 F.3d 610, 619-620 (2d Cir. 2006) (citing *Hall Holding Co.*, 285 F.3d at 437); *Donovan v. Cunningham*, 716 F.2d 1455, 1467 (5th Cir. 1983). Thus, once a court concludes that there was no good faith determination of fair market value of the asset by the trustee, this method provides a straight forward means for the court to calculate loss without undertaking the difficult task of reconciling conflicting valuation testimony in an attempt to redetermine *de novo* what should have been paid for the stock.

D. The Total Payments Made On The ESOP Loan

In *Valley National Bank*, the court concluded that the losses resulting from an imprudent leveraged ESOP transaction equaled the total payments made by the ESOP in the transaction. *Valley Nat'l Bank*, 837 F. Supp. at 1289. In *Valley*, the ESOP trustee agreed to a leveraged purchase of a company whose sales were in decline and whose "present operations did not generate enough cash flow to finance the debt required to finance the LBO." *Id.* at 1265. After the LBO, the company struggled for nearly four years, during which time the company made $ 17.5 million in contributions to the ESOP which was used to repay the debt from the LBO. *Id.* at 1270. When the company "self-destructed in debt" and declared bankruptcy, the ESOP's investment became worthless. *Id.* at 1270-71. The *Valley* court concluded that the loss suffered by the ESOP as a result of the trustees' imprudent decision to enter into the leveraged ESOP transaction equaled the $17.5 million lost ESOP contributions given as consideration for its shares. *Id.* at 1287.

V. OTHER REMEDIES AVAILABLE UNDER ERISA §§ 409(a) And 502(a)(3)

A. Rescission

One appropriate remedy under 409(a) is rescission of an unlawful transaction. *Eaves*, 587 F.2d at 463; *see* 4 Scott, *supra* § 24.13 (explaining that when a trustee commits a breach of trust "by making an improper investment" the beneficiaries have the option of "reject[ing] the purchase"). In *Eaves*, the court found that both the former trustee and successor trustee (appointed by the former trustee) breached their fiduciary duties under ERISA by entering into an ESOP transaction. *Eaves v. Penn*, 426 F. Supp. 830, 836-37 (W.D. Okla. 1976). The court concluded that "[a]n order of rescission, setting aside or voiding the unlawful transaction" was the appropriate remedy "to restore the plan participants and beneficiaries to the position in which they would have been but for the unlawful acts." *Id.* at 838, *aff'd*, 587 F.2d at 463 (10th Cir. 1978). The parallel provisions of the IRC, Section 4975(a), govern prohibited transactions between an ESOP and disqualified persons, "impose a tax if the prohibited transaction is not corrected (*i.e.*, reversed)." *Eyler v. Comm'r*, 88 F.3d 445, 448 (7th Cir. 1996). A "correction" in § 4975(f)(5) is defined as "with respect to a prohibited transaction, undoing the transaction *to the extent possible*, but in any case placing the plan in a financial position not worse than that in which it would be if the disqualified person were acting under the highest fiduciary standards" and requires "rescission of the sale where possible." *Baizer v. Comm'r*, 204 F.3d 1231, 1236-1237 (9th Cir. 2000) (emphasis added). These "tax provisions of Title II contain a mechanism" to "undo prohibited transactions prior to the imposition of the 100 percent excise tax" by the IRS. *McDougall v. Donovan*, 539 F. Supp. 596, 599 (N.D. Ill. 1982).

B. Restitution Of Profits Made By A Fiduciary

Under ERISA § 409(a), a breaching fiduciary is liable for "restitution ('to restore to [the] plan any profits of such fiduciary which have been made through use of assets of the plan *by* the fiduciary')." *Mertens*, 508 U.S. at 252. ERISA § 406(b) "clearly contemplates actions against fiduciaries who profit by using trust assets, *even where the plan beneficiaries do not suffer direct financial loss*." *Leigh*, 727 F.2d at 122 (finding that fiduciaries who used plan assets for own personal gain, but caused no loss to the plan were required to disgorge the profits); *see Scala v.*

Scrufari, 479 F.3d 213, 221-222 (2d Cir. 2007) (finding trustee who improperly set his own salary and benefits using trust funds was required to restore to the plan those benefits that he received even if the plan suffered no loss). Disgorgement of such profits is consistent with the common law of trusts in order to deny fiduciaries any profits from their use of trust assets. *See id.* (citing G. Bogert, *The Law of Trusts and Trustees* § 543 at 218 (2d ed. 1978). Under the well-established common law rule, a trustee is not permitted to retain "any profit" from the use of trust assets "regardless of whether there has been a breach of trust" and "whether the profit takes the form of payment from a third person or the trustee uses the property personally." 4 A. Scott, *Scott & Ascher on Trusts* § 24.7 at 1682-83 (4th ed. 2007); Restatement (Second) of Trusts § 203 & cmt. a. The Scott treatise explains that a trustee who (or whose company) receives a bonus or commission arising out of the use of trust assets cannot retain it (even if there is no breach of trust). Scott, *supra* at 1683.

C. Removal & Permanent Injunction Barring Service As A Fiduciary

Under Section 409(a), removal of fiduciary is appropriate "even for honest but imprudent conduct." *Solis v. Cooper*, No. 1:10-cv-152, 2011 U.S. Dist. LEXIS 11903, *5 (N.D. Ind. Feb. 4, 2011) (citing *Brock v. Robbins*, 830 F.2d 640, 647-48 (7th Cir. 1987) (same); 4 Scott, *supra* § 24.3.5 ("The court may remove a trustee who is not properly administering the trust."). Of course, "it is self-evident that such a remedy" is appropriate where individuals engage in "self-dealing." *Beck v. Levering*, 947 F.2d 639, 641 (2d Cir. 1991); *Chao v. Malkani*, 452 F.3d 290, 298 (4th Cir. 2006) (removing fiduciaries who "acted in an objectively unreasonable manner that conflicted with their duties" was proper). This remedy is also available in actions brought by plan participants. *E.g.*, *Freund*, 485 F. Supp. at 644 (ordering that "[a]ll defendants be removed from serving in any fiduciary capacity with respect to the Plan and that they be enjoined from further violations of ERISA.").

The "wide discretion" afforded courts "in fashioning equitable relief to protect the rights of pension fund beneficiaries" also includes "a permanent injunction barring a former ERISA fiduciary from providing services or acting as a fiduciary to any employee benefit plan in the future." *Chao v. Merino,* 452 F.3d 174, 185 (2d Cir. 2006); *Feilen*, 965 F.2d at 673 (upholding injunction barring professional fiduciary from serving as fiduciary of an ERISA plan). In *Merino,* the Second Circuit concluded that such a permanent injunction was appropriate for a fiduciary who did not personally benefit from the fiduciary breaches, but merely "sat back and did nothing to protect the Fund" from the breaches of another fiduciary. *Merino,* 452 F.3d at 186 (concluding that such a remedy was not limited to circumstances where a fiduciary had himself engaged in self-dealing); *see also Reich v. Lancaste*r, 843 F. Supp. 194, 204 (N.D. Tex 1993) (barring defendant from serving as fiduciary because his "primary concern in working with the Fund was to make as much money as possible without any concern for the economic welfare of the fund"), *aff'd*, 55 F.3d 1034 (5th Cir. 1995).

D. Equitable Restitution Or Disgorgement Of Ill-Gotten Gains

Another equitable remedy available is restitution to require a non-fiduciary to disgorge any ill-gotten plan assets or profits derived from participation in a fiduciary breach. *Knudson,* 534 U.S. at 213-214. As the Supreme Court explained, restitution in equity ordinarily takes the form of a constructive trust or an equitable lien and seeks to "restore to the plaintiff particular funds or property in the defendant's possession." *Id.*; *see Sereboff v. Mid Atlantic Med. Servs., Inc.*, 547 U.S. 356, 362-63 (2006) (allowing equitable relief when there were identifiable funds in defendant's possession). A court of equity could then order a defendant to transfer title (in the case of the constructive trust) or to give a security interest (in the case of the equitable lien) to a plaintiff. *Id.* "A restitutionary award focuses on the defendant's wrongfully obtained gain . . . [and] seeks to punish the wrongdoer by taking his ill-gotten gains, thus, removing his incentive to perform the wrongful act again." *Kerr v. Charles F. Vatterott & Co.*, 184 F.3d 938, 944 (8th Cir. 1999). The effect of this remedy is "to give the plaintiff the gain a defendant makes from the sale of the plaintiff's property and any reinvestment of the funds." 1 Dan B. Dobbs, *Law of Remedies* § 4.3(1), at 587-89 (2d ed. 1993).

E. Accounting For Profits

In addition to restitution, the equitable remedy of accounting for profits is also available under Section 502(a)(3). As the Supreme Court explained, while equitable restitution requires that a particular fund or property be traceable, no such tracing requirement applies with respect to accounting for profits. *Knudson*, 534 U.S. at 214, n. 2. (explaining that a plaintiff "may also recover profits produced by the defendant's use of that property, even if he cannot identify a particular res containing the profits sought to be recovered."). The treatises on Trusts and Remedies confirm that a non-fiduciary is subject to the equitable remedy of accounting for profits. 4 Austin Scott & William F. Fratcher, *The Law of Trusts* § 291.3 (4th ed. 1989) (explaining non-fiduciary transferee "is accountable for any profit he has made"); Dobbs, *supra* § 4.3(5) at 411-12 ("[A] wrongdoer, who is not a fiduciary may be forced to give up his gains … and profits can be awarded against non-fiduciaries."). "Unlike the [constructive] trust, . . . [an] accounting does not seek any particular *res* or fund of money; the defendant will be forced to yield up profits, but the defendant can pay from any monies he might have, not some special account." 1 Dobbs, *supra* § 4.3(2) at 588. The purpose of an accounting for profits is to "disgorge gains received from improper use of the plaintiff's property or entitlements." 1 Dobbs, *supra* § 4.3(5) at 610; *see Moore v. CapitalCare, Inc.*, 461 F.3d 1, 13 (D.C. Cir. 2006) ("An accounting for profits 'is a restitutionary remedy based upon avoiding unjust enrichment' and its purpose is to 'disgorge gains received from improper use of the plaintiff's property or entitlements.'"). Even where there is no way to "account for . . . gain," a plaintiff may simply use interest when a defendant "has had use of [plaintiff's money]" even if defendant did not actually reap interest or profits. *Parke v. First Reliance Standard Life Ins. Co.*, 368 F.3d 999, 1009 (8th Cir. 2004).

F. Prejudgment Interest

In this Circuit, prejudgment interest is "presumptively available to victims of federal law violations" because "[w]ithout it, compensation of the plaintiff is incomplete . . . ." *Fritcher v. Health Care Serv. Corp.*, 301 F.3d 811, 819-20 (7th Cir. 2002) (internal citations omitted). The presumption in favor of prejudgment interest awards is "specifically applicable to ERISA cases." *Id.* The award of prejudgment interest applies in ERISA fiduciary breach cases involving the misuse of plan assets and does not require a finding of bad faith. *See Chao v. Current Dev. Corp*., No. 30 C 1792, 2007 U.S. Dist. LEXIS 89007, *4-6 (N.D. Ill. Nov. 30, 2007) (awarding prejudgment interest). In the event that a judgment for plaintiffs does not otherwise take into account the time value of the monetary losses suffered by the ESOP, [5] prejudgment interest is necessary to "make the injured plan whole." *Briody*, 732 F.2d at 1337.

VI. THE REMEDIES AGAINST THESE DEFENDANTS

A. The Potential *Fiduciary* Liability Under § 409(a) Of ERISA Of Alpha And The Trustees Of The Trachte ESOP

The Complaint alleges that the Alpha Defendants and the Trachte Trustee Defendants violated ERISA § 404 and 406 by imprudently failing to conduct an adequate investigation of the 2007 Transaction and causing the Trachte ESOP to engage in a prohibited transaction by

[5] Plaintiffs' Expert Kevin Kreitzman has provided a number of alternative means of calculating the losses and, where appropriate, has included a calculation of the "present value" of such losses to take into account the time value of money by applying a "risk free" rate of return to the presumed loss. By comparing the price of zero coupon US treasury securities that mature on 2/29/2012 to their price on August 29, 2007 and using that rate to adjust the losses, Kreitzman has in effect included in his loss computations an element for prejudgment interest calculated at the conservative rate of return of risk free U.S. Treasury securities.

acquiring 100% of the outstanding shares of Trachte from the Selling Defendants. Compl. ¶¶ 244- 263. Violations of these provisions subject these Defendants to a number of equitable and remedial remedies under ERISA § 409(a). In selecting the remedy, the Court should "enforce the remedy which is most advantageous to the participants," and has the greatest likelihood of "restoring plan participants to the position in which they would have occupied but for the breach of trust." *Supra* III.

1. <u>**Rescission Of The 2007 Transaction "To The Extent Possible"**</u>

One potential remedy is to rescind the 2007 Transaction "to the extent possible." *Supra* V.A. At a minimum, this would require returning approximately $28 million in consideration which the Trachte ESOP gave to AHI and Alliance in the form of the assets from the Trachte employee accounts and cash the Trachte ESOP borrowed from Trachte[6] in exchange for approximately 2100 shares of Trachte common stock the Trachte ESOP received from Alliance.[7] As Pagelow is no longer a Defendant, the Court may not be able to rescind the sale of the Pagelow shares to the Trachte ESOP; however, even if rescission is not complete as to all parties is irrelevant as a prohibited transaction need only be rescinded or corrected "to the extent possible." *Id.* To the extent that there are losses associated with the purchase of shares from

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[6] According to the BWVS Fairness Opinion the Trachte ESOP acquired 568.5428 shares of Trachte common stock from Alliance in exchange for $7,981,925 in stock and cash held in the participant accounts of the Trachte employees which were transferred from the Alliance ESOP to the Trachte ESOP as part of the Spin-Off. *See* Joint Trial Exhibit ("J.E.") 29, D.E. 587. Additionally, the Trachte ESOP purchased 1,530.1827 shares of Trachte stock from AHI for $21,002,523 in cash which was loaned to the Trachte ESOP by Trachte. *Id.* Thus, in total Alliance exchanged or sold approximately 2100 shares of Trachte common stock to the Trachte ESOP for total consideration of approximately $28 million. *Id.*

[7] To completely undo the 2007 Transaction the Court would also have to order that the $2,000,000 in preferred Trachte stock and 573.7976 shares of Trachte common stock which Trachte purchased from Alliance in exchange for a promissory note of $4,370,000 be unwound as well. J.E. 29, D.E. 587. This would require Trachte conveying the preferred and common stock back to Alliance in exchange for the note and any payments Trachte made upon the note. Since shares of Trachte are now worthless, by decreasing the company's indebtedness it would have the effect of increasing the value of Trachte and its common shares.

Pagelow (i.e. at more than fair market value),[8] the Court could, in addition to rescinding the sale to Alliance, direct that the fiduciaries whose breaches caused the overpayment to Pagelow restore the losses to the Trachte ESOP. Assuming that the excess payment to Pagelow was not required under his put option, the losses resulting from purchase of the Pagelow shares range from $6.9 million (the difference between what the ESOP paid for the shares and what they are worth today) to $5.3 million (the difference between the what the ESOP paid for the shares and their fair market value on the date of the 2007 Transaction). *See* Kreitzman Rep. ¶ 12.

Defendants may argue that rescission coupled with the restoration of losses related to Pagelow will result in a windfall to the Trachte ESOP. Yet, such an argument would ignore that as part of a rescission, the Trachte ESOP would have to pay off the Trachte loan which currently has a loan balance of $25 million. *See* Kreitzman Rep. ¶ 15. Thus, the actual recovery by the Trachte ESOP would only be an amount which approximates the consideration that has been paid by the ESOP to date. *See infra* VI.A.2.c.

2. <u>Direct The Trachte ESOP Fiduciaries To Restore The Losses To The Trachte ESOP Resulting From The Breach</u>

Under ERISA § 409(a), the Trachte Trustees and/or the Alpha Defendants can be ordered to restore the losses suffered by the Trachte ESOP as a result of engaging in the 2007 Transaction utilizing any of the methods below. *See Supra* II.A.

a. Difference Between Price Paid And Current Market Value Of Trachte Stock

The simplest and the most straight-forward method of calculating losses resulting from the imprudent decision of the fiduciaries to enter into the 2007 Transaction is to compare the

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[8] If the Court concludes that Pagelow would have been entitled to receive the amount he did under the put option (or some amount greater than fair market value at the time of the Transaction), then Trachte's obligation to purchase those shares from Pagelow should have been subtracted from the value of Trachte. *See* Kreitzman Rep. ¶ 12 & n.7. Thus, such an obligation would simply increase the overpayment attributable to Alliance. *Id.*.

price that the Trachte ESOP paid for the Trachte shares with the value, of those shares today. *Supra* IV.C. Since Trachte shares currently have no value the loss suffered by the ESOP is the entire $34 million paid by the Trachte ESOP to acquire 100% of the outstanding common shares of Trachte in the 2007 Transaction. Kreitzman Report Appx. 7. In essence, this loss number represents the sum of the $7.9 million value of the Trachte Employee account balances in the Alliance ESOP which were "spun off" to the Trachte ESOP and were exchanged for 568.5428 shares from Alliance <u>plus</u> the $26.7 million loan used to purchase approximately 1,944 shares of Trachte common stock from Pagelow and Alliance.[9] *See id.* This remedy alone, however, would not account for the other consideration paid in the 2007 Transaction.

Defendants may argue that the Trachte ESOP did not actually suffer a loss of the entire purchase price because the Trachte ESOP purchased a majority of shares with borrowed money; however, merely utilizing a loan to purchase shares does not mean that the ESOP did not suffer a loss of the entire loan proceeds in the 2007 Transaction. As another court in this Circuit explained when confronted by a similar argument:

> Imagine that the purchaser of a home borrows, from the seller himself, $200,000 with which to buy that home. . . No one would seriously contend that the buyer did not purchase the home for $200,000, even if he borrowed the money for the transaction.
>
> Now imagine that the home burns down. The value of what is lost is not the value of the cumulative mortgage payments to the date of the home's destruction, but rather the loss of the entire purchase price (or the home's current fair market value). If the seller decides to forgive the remaining payments on the home after its destruction, that does not mean what was "lost" is only the sum total of the payments already made--the home no longer exists.

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9 The Trachte ESOP purchased 1,530.1827 shares of Trachte stock from AHI for $21,002,523 plus an additional 413.464 share from Pagelow for $5,675,000 with the proceeds of the $26,677,523 loan which the ESOP obtained from Trachte. J.E. No. 33 at TRUSTEES 00014161-2 (D.E. 587-4); J.E. No. 29 at TRUSTEES00014448 (D.E. 587). Thus, the ESOP purchased a total of 1,944 shares of Trachte stock from Pagelow and Alliance with the proceeds of the Trachte loan.

Neil, 767 F. Supp. 2d at 941. In this case, the Trachte loan is still outstanding and the Trachte ESOP continues to pay down the loan based on contributions from Trachte. In fact, between August 29, 2007 and December 31, 2010 the Trachte ESOP received contributions totaling $5,003,939 which have been use to service the debt and pay down the loan. As of December 2011, the current outstanding balance on the loan is $25 million. Kreitzman Rep. ¶ 15.

b. Difference Between The Price Paid And Fair Market Value As Of The Date Of The 2007 Transaction

The Court may also determine losses based upon the difference between the price paid by the Trachte ESOP and the fair market value of Trachte shares on the date of the Transaction. *Supra* IV.B. As set forth in Mr. Kreitzman's report (and trial testimony), the fair market value of the Trachte on the date of the Transaction was between $16.2 million and $18 million. Kreitzman Rep. ¶¶ 12-14, 16 & Appx. 1 & 2 By this measure, the Trachte ESOP overpaid by between $22.4 and $20.6 million.[10] *See id.* Computing the losses in this fashion fails to take into account the fact that the ESOP still owes $25 million on the loan from Trachte. Kreitzman Rep. ¶ 15**.** As this method would not restore value to the Trachte ESOP, net of ESOP debt, it is not the

[10] In his initial expert report, Mr. Kreitzman concluded that the fair market value of Trachte was $16,199,946 by utilizing the same management projections and assumptions as BWVS in its Income Approach and then corrected for various errors in the BWVS valuation. Among the errors corrected was the assumption that Trachte's capital investment would be less than depreciation in perpetuity, a situation that is not possible. *See* Kreitzman Rep. ¶ 16. Instead, Kreitzman adjusted the projections and terminal value used in the BWVS discounted cash flow analysis to reflect a capital growth rate from 2007 forward which was equal to the 3% growth rate assumed in the BWVS model. *See id.*.

At trial on Phase 1, Rosanne Aumiller testified that the use of capital investment amounts which were less than depreciation for the first several years of her discounted cash flow analysis was justified because Trachte had made significant capital investments in 2006 which would have compensated for the lower levels used in her projections for 2007 and 2008. Based upon this testimony, Mr. Kreitzman has performed an alternative valuation of Trachte which assumes that the lower capital growth rates assumed by BWVS could be sustained for several years in light of the substantial capital investment by Trachte in 2006 and only adjusted the capital growth rate to reflect a 3% growth in 2009 and after. *See id*. With this adjustment, the fair market value of Trachte on the date of the Transaction increased by $1.8 million from $16.19 to $18 million. *Id.* As a result, the total overpayment by the Trachte ESOP for the stock of Trachte would decrease by $1.8 million to $20.6 million. *See id*.

remedy which is "most advantageous to the participants." Indeed, after considering the ESOP debt, the application of this measure of loss does not restore the $7.9 million in Trachte employee account balances in the Alliance ESOP that existed prior to the 2007 Transaction.

c. The Total Payments Made By The Trachte ESOP

Another means of calculating the loss is the method applied in *Valley National Bank* where the loss was based on the total contributions received by the ESOP that were used to pay down the ESOP debt from the LBO before the sponsor's bankruptcy. *Supra* IV.D. In addition to exchanging the $7.9 million in Trachte employee account balances to acquire Trachte shares, the Trachte ESOP also has received contributions from Trachte between August 29, 2007 and December 31, 2010 totaling $5,003,939, which have been use to service the debt and pay down the Trachte loan to the Trachte ESOP. Kreitzman Rep. ¶ 21. Assuming that the ESOP continued to receive contributions at a comparable level in 2011 and 2012 which were used to service the Trachte ESOP debt, the present value of the loss computed in this manner is about $16.5 million. *See* Kreitzman Rep. ¶ 21 & Appx. 4. Unlike *Valley National Bank*, the company, Trachte, has not declared bankruptcy and the loan remains outstanding. As a result, this measure of loss ignores the Trachte ESOP's continuing liability for the remaining debt incurred in the 2007 Transaction, which is currently greater than the losses computed in this fashion. Absent forgiveness of the Trachte ESOP debt, losses calculated in this manner would not restore <u>any</u> funds to the Trachte ESOP, net of the debt, and would not restore "plan participants to the position in which they would have occupied but for" the fiduciary breach.

d. The Difference Between What The Plan Earned And What A Prudent Investment Would Have Earned

Another means of calculating the loss suffered the Trachte ESOP would be to compare the current value of the Trachte shares with what the consideration given for such shares would have been worth today if it had been prudently invested from 2007 to the present. *Supra* IV.A. According to the BWVS Fairness Opinion, the total consideration paid for the 100% interest in Trachte in the 2007 Transaction was $38.3 million. J.E. 33. The present value of the consideration paid for now worthless shares of Trachte, assuming it was invested in and grew at the same rate of return as "risk free" zero coupon US treasury securities, would be $46 million (or $41 million for the amount paid only by the ESOP) as of February 15, 2012.[11] Kreitzman Rep. at Appx 7.

3. Removal Of & Injunctions Against The Trachte ESOP Fiduciaries

As of the trial on Phase 1, Defendants Mastrangelo and Klute continued to serve as (now non-directed) trustees of the Trachte ESOP. In light of their failure to appreciate their own duties (even as purported directed trustees), the abdication of their duties to others, and general failure to fulfill their duties, removal of them as fiduciaries and an order barring any of the Trachte Trustees from serving as fiduciaries of any Trachte employee benefit plan is appropriate. *See Supra* V.C.

As of the closing of the 2007 Transaction, the Alpha Defendants ceased serving as fiduciaries of the Trachte ESOP. Nonetheless, the Alpha Defendants hold themselves out as professional fiduciaries, including for ESOPs. In light of their failure to appreciate their own duties (particularly, given their continued assertion that they had no fiduciary duties despite acknowledging in writing that they would be a fiduciary), and their general failure to fulfill their duties, an order barring the Alpha Defendants from serving as non-directed fiduciaries for any

[11] Of this amount approximately $9.6 million represents the loss suffered in the Trachte employee's accounts in the Alliance ESOP that resulted from the fiduciary breach of the Alliance fiduciaries as a result of their approving the share exchange. *See*, *infra*. IV.B.1.

employee benefit plan and an in any capacity for any plan covering any class member or any Trachte plan is appropriate.[12]

B. Remedies Under ERISA § 409(a) As To Fenkell And Alliance As Fiduciaries Of The Alliance ESOP

The Complaint alleges that Fenkell and Alliance breached their fiduciary duties owed to the Trachte employees as participants in the Alliance ESOP and violated ERISA §§ 404 and 406. Compl. ¶¶ 210-243. [13] In short, Fenkell and/or Alliance violated ERISA § 404 and 406 by imprudently and disloyally transferring the Trachte employee accounts in the Alliance ESOP to the Trachte ESOP as part of the Spin-Off when they knew that such accounts would have less value after the transfer and by causing the Alliance ESOP to enter into a prohibited transaction for the benefit of Fenkell a party in interest to the Alliance ESOP who personally and directly benefited from the 2007 Transaction. By engaging in these violations, Fenkell and/or Alliance may be liable for all of the equitable and remedial remedies provided under ERISA § 409(a). *Supra* II.A. As fiduciaries only as to the Alliance ESOP (and its participants), however, the losses caused as a result of their fiduciary breach are less than those losses caused to the Trachte ESOP.

1. <u>Restoration Of The Losses Suffered In The Accounts Of The Trachte Employees In The Alliance ESOP</u>

At the trial on Phase 1, the Alliance Defendants did not offer any evidence to rebut Plaintiffs' evidence that the sum of the balances of the Trachte employees were not the same immediately before the Spin-off Date (August 29, 2007) as they were before the Spin-off Date as

12 Given that the Alpha Defendants' only applicable insurance policy appears to exclude acting as a fiduciary of an ESOP, this is the only remedy against the Alpha Defendants that will have any practical effect for the Trachte employees unless the Alpha Defendants have any significant assets (which is unlikely). *See* Exhibit A to Declaration of R. Joseph Barton at §§ 11.b and 22.

13 Plaintiffs understand that the Court granted summary judgment on Count I, the claim under ERISA § 208. As such, remedies for that claim are not addressed.

required under the terms of the Spin-off Instrument and the terms of the Plan. Instead, the Alliance Defendants sole defense appeared to be that neither Fenkell nor Alliance had any fiduciary duties in the 2007 Transaction. As such, there can be little dispute that the accounts of the Trachte employees after the Spin-off Date (i.e. in the Trachte ESOP) were worth less than their accounts before the Spin-off Date (i.e. in the Alliance ESOP). As a result, one appropriate measure of loss is the difference between the value of the Trachte employee accounts versus what the participant accounts would have earned had they been retained in the Alliance ESOP (or otherwise invested prudently and according to the terms of the plan). *Supra* IV.A. If the Trachte employee accounts in the Alliance ESOP had remained in the Alliance ESOP rather than being transferred to the Trachte ESOP and invested in now worthless Trachte stock, the value of those accounts would be $9,415,574.51. *See* Kreitzman Rep. ¶ 18. Alternatively, if the accounts had been invested in risk-free zero coupon Treasury securities from August 29, 2007 to the present they would have a value of $9,630,817. *Id.* ¶ 19.

2. <u>Disgorgement Of The Profits Made Through The Use Of The Assets In The Accounts Of The Trachte Employees In The Alliance ESOP</u>

Here, there is little dispute that the transfer of Trachte employee accounts which were assets of the Alliance ESOP facilitated the 2007 Transaction. There is no dispute that Fenkell received $2.9 million as a result of the 2007 Transaction, which he would not have received unless there was a sale of Trachte (because the phantom stock payment was triggered by a change in control). In fact, what he received was actually more than what was required under the terms of the Phantom Stock Plan. *See* Kreitzman Rep. ¶ 22. As such, the $2.9 million Phantom Stock payment received by Fenkell constitutes a profit derived through the use of the Trachte employee account balances in the Alliance ESOP. Under ERISA 409(a), Fenkell is required to disgorge the $2.9 million he received from the 2007 Transaction (as well as account for any profits he received).[14]

3. Rescission

Another appropriate remedy available against Fenkell and Alliance as fiduciaries of the Alliance ESOP under ERISA § 409(a) is rescission. *Supra* V.A. At a minimum, this would take the form of rescinding the transfer of the assets of the Trachte employee accounts from the Alliance ESOP to the Trachte ESOP (which would have a present value of $9.4. *Supra* IV.B.1. As Section 2 of the Closing Memorandum provided that the consummation of each step of the 2007 Transaction was "conditioned upon the consummation of all transactions," all of the steps of the 2007 Transaction should be rescinded to the extent possible. *See* Plaintiffs' Trial Ex. 386 at Alliance1057 (D.E. 600).

4. Removal Of Fenkell As A Trustee Of The Alliance ESOP

During the Phase 1 trial, Defendant Fenkell conceded that he did nothing (or virtually nothing) to fulfill his duties as a fiduciary of the Alliance ESOP. In fact, his primary defense was that he had no fiduciary duties (a conclusion that he reached on his own without consulting counsel). Quite simply, Fenkell demonstrated that he abdicated his fiduciary role to others (specifically, Wanko) and that his primary motive in using the assets of the Alliance ESOP was to obtain profit without regard to the best interests of the plan participants. Moreover, his conflicting interests as a result of phantom stock arrangement further undermine his fiduciary duties. In order to prevent Fenkell from engaging in violations of ERISA with respect to the

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[14] As a result of Alliance's actions in transferring the Trachte employee accounts in the Alliance ESOP to the Trachte ESOP, which facilitated the purchase of 100% of the outstanding shares of Trachte stock by the Trachte ESOP, Alliance was able to sell approximately 2,100 shares of the Trachte stock to the Trachte ESOP for more than the fair market value of the shares. As a result, Alliance profited from the approximately $18 million overpayment which it received for its shares from the Trachte ESOP for which it is liable to make restitution to the Alliance ESOP under 409(a) for the use of its assets.

Alliance ESOP, he should be removed as Trustee and enjoined from serving in a fiduciary capacity with respect to any ERISA covered pension plan

C. Remedies Against The Alliance Defendants As Non-Fiduciaries Under ERISA § 502(A)(3)

Assuming the Court finds that Fenkell and/or Alliance had no fiduciary duties or did not breach any fiduciary duties (or violate ERISA § 406 with respect to the Alliance ESOP), as *non-fiduciaries* they may be liable for knowingly participating in the fiduciary breaches and prohibited transactions engaged in by: (1) the fiduciaries of the Trachte ESOP alleged in Counts IV, VII, VIII and IX, *see* Compl. Count XIV and/or (2) the fiduciaries of the Alliance ESOP alleged in Counts II, III, IV, and V, *see* Compl. Count XV. There can be little dispute that Fenkell and Alliance even as *non*-fiduciaries (and parties-in-interest to the Alliance ESOP) arranged to transfer Trachte employee accounts in the Alliance ESOP to the Trachte ESOP in order to facilitate the 2007 Transaction. Alliance benefited by obtaining a sale of Trachte stock to the Trachte ESOP at a price and on terms it otherwise could not have obtained and for more than their fair market value. Fenkell benefited as a result of a change in control of Trachte which triggered payments to Fenkell under the Trachte Phantom Stock Plan. As liability for the Non-Fiduciary Claims are based upon violations of the duties imposed under ERISA § 502(a)(3), Plaintiffs are entitled to "other appropriate equitable relief" which includes those remedies that were typically available in equity. *Supra* II.B.3. Such remedies include rescission, equitable restitution in the form of a constructive trust or equitable lien, and accounting for profits (disgorgement of profits). *Id.*

1. <u>Rescission Of The 2007 Transaction</u>

Of course, one potential remedy against Fenkell and/or Alliance as non-fiduciaries is rescission. *Supra* V.A. This would require that Alliance rescind the exchange of 568.5428 shares of Trachte stock to the Trachte ESOP for which Alliance received in return the shares (and cash) of Alliance and AH Transition stock held in the Trachte employee accounts in the Alliance ESOP as well as the additional money that Alliance received from the sale of Trachte stock to the Trachte ESOP. *Supra* VI.A 1 & VI.B.3. This remedy would restore the Trachte employees the accounts to which they would have been entitled as participants in under the Alliance ESOP and restore the consideration paid by the Trachte ESOP (which would pay off the ESOP debt).

2. Equitable Restitution Or Disgorgement Of Ill-Gotten Gains

To the extent that Fenkell or Alliance knowingly participated in the breaches or violations of fiduciaries in the 2007 Transaction, there should be little dispute that they actually received funds as a result of the 2007 Transaction. *See Chesemore v. Alliance Holdings, Inc.*, 770 F. Supp. 2d 950, 978 (W.D. Wis. 2011). The funds received as result of their knowing participation, are subject to equitable restitution and defendants can be required to disgorge all such funds or the proceeds. *Supra* V.D.

a. Alliance

Alliance will likely argue that the funds need to be "clearly traceable" and neither the funds nor their proceeds can be traced because Alliance has commingled them with non-tainted funds. Yet, "[t]he law of trusts supplies an elaborate set of tracing rules." *United States v. $ 448,342.85*, 969 F.2d 474, 477 (7th Cir. 1992) (citing the Restatement (Second) of Trusts and Restatement of Restitution). As the Restatement of Restitution explains, "[a] person whose money, is wrongfully mingled with money of the wrongdoer does not thereby lose his interest in the money although the identity of his money can no longer be shown, but he acquires an interest in the mingled fund." Restatement of Restitution § 209 & cmt. a. By way of example, the Restatement explains that if a wrongdoer takes ten $5 bills belonging to another and places it in a wallet with some of his own, the wronged person is entitled ten of the $5 bills "even though he is unable to identify the [specific] bills which he owned." *Id.* at Ill. No. 1. Another illustration apt to the facts of this case is as follows: "A wrongfully takes $1000 of B's money, and with this money and with $2000 of his own money A purchases shares of stock which he later sells for $6000. B is entitled to receive one-third of the proceeds." Restatement of Restitution § 210 at Ill. No. 4; *see id.* § 212. Moreover, the wrongdoer "carriers the burden of disentangling" the commingled funds and like "any other constructive trustee" the law "requires [the wrongdoer] to resolve any doubts arising from his wrong" with any doubts resolved against the wrongdoer. *Leigh*, 727 F.2d at 138 n.38.

Addressing the issue of commingled funds in tracing illegal transactions and relying on the principles from the Restatement of Trusts, the Second Circuit explained that there are at least three basic approaches to tracing: (1) the "lowest intermediate balance rule," which considers the account to be traceable as long as the account never falls below the sum of the wrongfully acquired sum; (2) the "pro rata" (aka proportionate share) rule, which considers the "traceable proceeds" to be a pro rata share of any withdrawal from the account or any asset purchased with such withdrawal determined by the share determined by the ratio of the wrongfully taken sum to the funds in the account immediately after the deposit; and (3) an approach which considers traceable proceeds to be "any one withdrawal, or any asset purchased with such withdrawal to the extent of [the wrongfully acquired funds]." *United States v. Banco Cafetero Panama*¸ 797 F.2d 1154, 1159 (2d Cir. 1986); *see* Restatement (Second) of Trusts § 202. And "it is conclusively presumed in equity" that a wrongdoer "dissipates or spends his own funds first, before encroaching upon a trust fund." *Brown & Williamson Tobacco Corp. v. First Nat'l Bank of Blue Island*, 504 F.2d 998, 1002 (7th Cir. 1974). Such approaches do not need to be applied, however, "[w]here the wrongdoer has effectively separated the money of the other [i.e. the victim] from his own money, [and] the other [i.e. the victim] is entitled to, and only to, his own money or its product." Restatement of Restitution § 211.

As the Restatement of Trusts explains, a transferee can be charged as a "constructive trustee of the proceeds [of trust property]" and be "compel[ed] . . . to pay the proceeds and any income which he has received from the property prior to the sale and from the proceeds after the sale." Restatement (Second) of Trusts § 291 cmt. d. And where the transferee "has disposed of the proceeds or if the proceeds cannot be reached, the beneficiary can compel [the transferee] to pay the amount of the proceeds with interest thereon, together with any income which he received from the property before he sold it." *Id.* at cmt. e.

Utilizing these tracing principles, Plaintiffs' expert and summary witness Michael Spang has opined that a significant portion that the Trachte ESOP gave as consideration for 1,530.1827 shares of Trachte stock which the Trachte ESOP purchased from Alliance can be traced to assets and accounts which are still in the possession of Alliance. *See* Report of Michael Spang. With respect to the AH Transition securities that were transferred as part of the share exchange, those are still held by AH Transition as treasury shares. Deposition of AH Transition By Written Questions (D.E. 438-1) at No. 40. As such accounts and assets constitute the proceeds that Alliance received from the Trachte ESOP for the sale of Trachte stock, a constructive trust should be imposed over such proceeds and Alliance should be ordered to disgorge those proceeds.

b. Fenkell

Fenkell will likely argue that he has transferred the proceeds from the 2007 Transaction to his wife and no longer holds the proceeds. Yet, it is well established that "[w]here a person holding property in which another has a beneficial interest transfers title to the property in violation of his duty to the other, the transferee holds the property subject to the interest of the other, unless [s]he is a bona fide purchaser." Restatement of Restitution § 168(1) (emphasis added); *see* Restatement (Second) of Trusts §§ 289 & 292. As such, "when assets of a trust are improperly transferred by the trustee, the beneficiary may trace those assets and recover them from anyone but a bona fide purchaser for value." *Turley v. Mahan & Rowsey, Inc.*, 817 F.2d 682, 684 (10th Cir. 1987) (emphasis added). Unless Mrs. Fenkell paid value for the securities that Defendant Fenkell transferred to her account, she is a "gratuitous transferee" and will be required to make restitution. *See Landwehr v. DuPree*, 72 F.3d 726, 735 (9th Cir. 1995) (explaining that in an ERISA action that "[g]ratuitous transferees of a trust fund's assets are required to make restitution regardless of their lack of notice or knowledge."). As such, a constructive trust should also be imposed over any of the Phantom Stock payments which can be traced to Fenkell and or his wife.

3. Accounting For Profits

Under ERISA § 502(a)(3) the Court may also direct that both Fenkell and Alliance account for and disgorge to the Trachte ESOP any profits which they have made with the proceeds they derived as a result of their participation in the fiduciary breaches of the fiduciaries of the Trachte ESOP. To that, Alliance and/or Fenkell claim that they have dissipated the proceeds they received from the 2007 Transaction and such proceeds are no longer traceable. The Trachte ESOP is still entitled to recover any profits which Fenkell and Alliance obtained from the use of such assets *regardless of* whether such profits can be traced to specific property or assets currently in the possession of Fenkell or Alliance. *Supra* C.2.a. As the Seventh Circuit explained in an infringement case seeking an accounting of profits, "exactness is not required," the burden rests on the wrongdoer to show that he did not profit and to the extent that legitimate profit cannot be segregated from profit based on wrongfully acquired assets, the innocent party is entitled to the entire profit. *See WMS Gaming, Inc. v. WPC Prods. Ltd.*, 542 F.3d 601, 608-09 (7th Cir. 2008). Thus, Defendants Alliance and Fenkell can be ordered to account for and disgorge their profits.

CONCLUSION

Accordingly, the Court should order the remedy that is in the best interests of the Class and the Subclass and that restores them to position they would have had but for breaches and violations of ERISA. Plaintiffs respectfully submit that those remedies consist of the following: (1) Rescission of the 2007 Transaction (and as necessary restitution and/or losses against the fiduciaries); (2) disgorgement of the profits by any fiduciary and (3) removal of the fiduciaries of the Plans and appropriate orders barring them from future service as fiduciaries.

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Respectfully submitted,

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