Case No. 00-2214

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

CAROL HARLEY, LENORA BANAZEWSKI, MICHAEL L. PAYTON, RICHARD ZOESCH, individually and on behalf of all others similarly situated

Plaintiffs – Appellants

v.

MINNESOTA MINING AND MANUFACTURING COMPANY

Defendant – Appellee

Appeal from the Orders of the United States District Court for the
District of Minnesota, entered on March 31, 1999 and March 29, 2000,
in Civil Action No. 4-96-488 (JRT/RLE),
granting Appellee's Motion for Summary Judgment

BRIEF OF *AMICUS CURIAE* ASSOCIATION OF PRIVATE PENSION AND WELFARE PLANS IN SUPPORT OF APPELLEE URGING AFFIRMANCE

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CORPORATE DISCLOSURE STATEMENT

Pursuant to Federal Rule of Appellate Procedure 26.1 and Eighth Circuit Rule 26.1A, the Association of Private Pension and Welfare Plans makes the following disclosure:

APPWP is a broad-based, non-profit trade association, organized under I.R.C. § 501(c)(6), which protects and fosters the growth of private, employer-sponsored employee benefit plans in the United States. APPWP has no share-holders or parent corporation. Its members include many publicly owned corporations.

August 10, 2000 ______________________ William F. Hanrahan

ISSUE PRESENTED

Whether the district court was correct in holding on summary judgment that an allegedly imprudent, $20 million pension plan investment resulted in no cognizable loss to a fully-funded, defined benefit plan, where the defendant employer paid $101 million of voluntary plan contributions in excess of what was required by law within six months after the investment loss, plus more than half a billion dollars of additional voluntary contributions during the next five years.

INTEREST OF THE ASSOCIATION OF PRIVATE PENSION AND WELFARE PLANS

The Association of Private Pension and Welfare Plans ("APPWP") is a broad-based, non-profit trade association founded in 1967 to protect and foster the growth of this nation's privately sponsored, employee benefit plans. APPWP members include both small and large employer-sponsors of employee benefit plans, including many Fortune 500 companies. Its members also include many plan support organizations, such as actuarial and consulting firms, insurers, banks, investment firms, and other professional benefit organizations. Collectively, its more than 250 members sponsor and administer plans covering more than 100 million plan participants and beneficiaries.

APPWP has a strong interest in this case because of its significance to employers and employees in a volatile and litigious investment climate. Sponsoring employers of defined benefit pension plans are responsible for funding plan benefits. Employers, not employees, bear investment risk. When a plan's investment portfolio incurs a net investment loss, the law requires that the sponsoring employer cover the loss within the next few years by making additional contributions to the plan to ensure that all promised benefits are paid. The law allows sponsoring employers to provide even more protection to their employees by making contributions to plans in excess of the legally required contributions. That is what happened here. The claim advanced by the plaintiffs-appellants would seriously undermine this voluntary aspect of the system for funding defined benefit pension plans by discouraging employers from routinely making contributions in excess of the legally required minimums.

The decision below correctly granted summary judgment against the plaintiffs by holding that the plan here did not suffer any cognizable damage as a result of the investment loss because the plan had assets far in excess of the amount needed to pay all promised benefits. While the district court's opinion focused principally on the consequences that flow from a plan holding such "surplus" funds, APPWP believes that this court should also focus on the legal effect of an employer making voluntary contributions in excess of the required minimums as a basis for upholding the judgment below.

STATEMENT OF FACTUAL AND LEGAL BACKGROUND

Appellee Minnesota Mining and Manufacturing Company ("3M") is the sponsoring employer of the 3M Retirement Income Plan (the "Plan"). The Plan is a defined benefit pension plan within the meaning of section 3(35) of the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. § 1002(35). A committee of 3M officers and other employees, the Pension Asset Committee ("PAC"), is responsible for appointing investment managers and overseeing the investment process. In late 1990, the PAC approved a $20 million investment in Granite Partners, L.P. ("Granite"). Granite was an investment company that invested in collateralized mortgage obligation derivatives. AP. 571. The Granite investment represented less than one percent of total Plan assets, which at the end of 1990 totaled approximately $2.5 billion. 3M 118.

The Granite investment appreciated to $33 million by the end of 1993, and then became worthless in early 1994 when interest rates increased sharply. AP. 324, AP. 577. At that time, Plan assets totaled approximately $3.4 billion, well in excess of the present value of accrued benefits by most of the accepted valuation measures. 3M 13, 3M 118.

As the Plan's sponsoring employer, 3M is required to fund the Plan with annual employer contributions. Minimum funding standards prescribed by ERISA and the Internal Revenue Code establish the minimum annual amounts that a sponsoring employer must contribute to its plans. The Internal Revenue Code also establishes an annual maximum amount that the employer may contribute to its plan. I.R.C. § 404(a).[1]

Each year, a plan's enrolled actuary calculates the minimum and maximum funding amounts that set the range over which the employer may contribute to its plan. Most employers choose to contribute an amount that is greater than the statutory minimum, but not greater than the statutory maximum. (Depending on a variety of factors, in some years, the minimum and maximum contributions may be the same amount.) Each year, the amount contributed is credited to the plan's "funding standard account." If the employer contributes more than the required minimum, the difference is treated as a "credit balance" that may be used in future years to reduce the employer's minimum contribution obligation. 3M 119-20. One of the consequences of creating such a credit balance by funding the

[1] The two statutes' funding rules are essentially identical. ERISA §§ 301-308, 29 U.S.C. §§ 1081-1086; I.R.C. § 412. This brief hereafter cites only I.R.C. § 412, not the parallel ERISA provisions, because the Internal Revenue Service ("IRS") has regulatory and interpretive authority over the minimum funding standards for purposes of both statutes.

plan more rapidly than the law requires is to ensure that the plan has more money available for investment sooner than it would if the employer made only the required minimum contribution.

The minimum funding standards take into account, among other factors, investment gains and losses. If the plan's total investment return for a plan year is greater than expected under the plan's actuarial assumptions, the excess gain is amortized over the next five years by reducing the annual minimum funding obligation. Similarly, if the plan's investment return is smaller than expected, the shortfall must be amortized over the next five years by increasing the annual minimum funding obligation. I.R.C. § 412(b)(2)(B)(iv) (losses) and (3)(B)(ii) (gains). Thus, the minimum funding rules contain their own self-correction mechanism to ensure that over time, the employer contributes an amount sufficient to pay all promised benefits, regardless of how well or how poorly the plan's investments fare. In other words, ERISA's minimum funding rules always place the risk of investment loss on the sponsoring employer, who has a statutory obligation to make up any shortfall in the plan's assets, regardless of the cause of that shortfall.

3M's history of contributions illustrates how these funding principles work in practice. In 1990 and 1991, the Plan's minimum and maximum contribution amounts were identical, and 3M contributed as much as it was allowed to contribute in those years, $41 million in 1990 and $22.5 million in 1991. In 1992, both the minimum and maximum contribution amounts were zero. Consequently, 3M made no contribution because none was allowed. In 1993, the Plan's minimum contribution was $49 million and its maximum contribution was $151 million. For that year, 3M contributed the maximum amount, which was $101 million more than 3M's legally required contribution. In each of the following three years, the Plan's minimum contribution amount was zero. Nevertheless, 3M chose to make contributions for 1994, 1995, and 1996 of $141 million, $150 million, and $121 million, respectively. Overall, from 1993 through 1996, 3M contributed over half a billion dollars more than the law required, or 25 times the amount of the $20 million Granite investment. 3M 119.

3M argued below not only that it voluntarily made excess contributions but that the Plan had surplus assets. Thus, the Plan and its participants were fully protected from the Granite loss regardless of whether one examines the Plan's excess contributions or its surplus assets. The plaintiffs did not dispute the existence of 3M's voluntary contributions, but did dispute the existence of surplus assets. Faced with these contentions, the district court in its initial opinion conservatively chose to examine both income and assets to determine whether the plaintiffs could establish damages. "The Court believes, in the unique circumstances of this case, that if 3M has indeed contributed amounts sufficient to put the Plan's portfolio in a surplus position, the Granite investment has not caused the Class of the Plan any cognizable harm." AP. 598. On the disputed surplus issue, the district court ruled in its second opinion that a surplus did indeed exist. Under the court's test, therefore, the plaintiffs could show no cognizable harm. AP. 676.

ARGUMENT

3M's Voluntary Contributions to the Plan Eliminate Any Liability 3M Might Otherwise Have, Regardless of Whether the Plan Has a Surplus.

The APPWP strongly supports the district court ruling that the Plan and its participants suffered no cognizable loss where 3M's excess contributions created a surplus. The APPWP submits this *amicus* brief, however, not simply to urge affirmance, but to suggest an additional ground for decision that is consistent with the law and with ERISA's overarching policy of encouraging financially secure pension plans. Whether or not the 3M Plan had surplus assets, 3M's voluntary contributions more than compensated the Plan for any loss arguably attributable to the Granite investment. Consequently, there is no basis for imposing an additional liability on 3M growing out of the Granite investment.

Two questions are presented. First, without considering the effect of any surplus, what is the effect of 3M's voluntary contributions under the minimum funding standards and under the law of remedies generally? In part A below, we demonstrate that 3M's voluntary contributions would eliminate liability in any other legal context and that the minimum funding standards plainly yield the same result here. The second question thus arises: do any other statutory provisions or policies justify the imposition of additional liability on a contributing employer who has paid more into a plan than the law requires? In part B, we show that imposing such a heavy burden on employers cannot be justified, and in fact would have adverse consequences that would harm plans and plan participants.

A. ERISA's minimum funding standards and the law of remedies both demonstrate that 3M's one-half billion dollars in excess contributions more than compensated for any arguable loss suffered by the Plan or its participants flowing from the $20 million invested with Granite.

Both at law and in equity, the courts have, in a variety of circumstances, recognized a simple principle that can be easily stated: if a debtor overpays his creditor, the debtor cannot be compelled to pay more. In one way or another, this principle is recognized in contract law, tort law, bankruptcy law, and trust law. This same principle should be applied here under the law governing defined benefit pension plans. Applying this principle here is consistent with the law, and will plainly promote the interests of all participants in defined benefit pension plans.[2]

Suppose a contract to repay a fixed amount in periodic installments allows the debtor to credit overpayments or ahead-of-schedule payments against the upcoming installments owed. Such a contract is comparable to ERISA's minimum funding standards, which impose a duty on the employer to make at least the annual minimum required contribution, but permit the employer to accumulate a "credit balance" by prepaying its future contribution obligations by contributing more than the annual required minimum. Once an employer creates this credit balance, the employer may freely use it to reduce or eliminate its funding obligations in future years until the credit balance is exhausted.

[2] The arguments we make here apply only to defined benefit pension plans because these plans have the unique characteristic of imposing on the sponsoring employers a statutory obligation to fund the plans in an amount sufficient to pay all promised benefits. In contrast, "defined contribution" pension plans, such as "401(k) plans," require only that the sponsoring employer contribute a stated amount of money to the plan, which is allocated to each participant's account. On retirement, the participant is entitled to the amount contributed, plus any investment gains (or losses) earned prior to retirement. In a defined contribution plan, the sponsoring employer has no investment risk.

Suppose further that the contract installment payments may be increased if an external event occurs, such as a rise in interest rates. If the debtor has made overpayments or ahead-of-schedule payments, then the rise in interest rates will have no immediate effect. The debtor can credit his additional payments against his new obligation to pay a higher amount in the future. Of course, over the longer term, the debtor will have to resume installment payments sooner than anticipated and in a higher amount than before, but this long-term consequence does not extinguish the debtor's right to apply his overpayments to satisfy his new obligation.

In the contract scenario, the debtor has no liability to the creditor if, having paid prior installments ahead of schedule, he neglects to increase his installment payments when interest rates rise. The debtor has no liability until the aggregate unpaid amounts exceed his "unused" installment payments. *See* D. Dobbs, 3 *Law of Remedies,* § 12.6(1) at 124 (2d ed. 1993) ("When the defendant has made prepayment or has partly performed to the benefit of the plaintiff, the defendant, though liable as a breacher, is normally entitled to a credit for prepayments or the value of part performance delivered"). These features of our hypothetical contract are analogous to the provisions of the minimum funding standards, which impose a duty on the employer to increase its contributions if certain events occur, such as failure to achieve the actuarially assumed return due to investment losses, but only after the employer has exhausted any credit balance it has accumulated.

A similar remedial principle applies in tort law. If the tortfeasor harms the victim, then he must pay damages. But if the tort incidentally conferred a benefit on the victim, the tortfeasor is entitled to offset the value of this benefit against the damages that he owes to the victim. For example, if a person trespasses on the victim's land and then digs a ditch that drains the land and makes it more productive and valuable, the tortfeasor is entitled to credit the benefit he conferred against the damage his trespass inflicted on the landowner. Restatement (2d) of Torts §§ 920A(1), 920 (1979). Here, unlike the contract example, the offsetting claims arise simultaneously. But this is merely a specialized example of a broader principle -- where two parties stand as debtors and creditors to each other, they may offset their obligations. *See Transit Casualty Company v. Selective Insurance Company of the Southeast*, 137 F.3d 540, 545 (8th Cir. 1998).

More generally, the Bankruptcy Code carefully protects the rights of setoff provided under state law. Where a creditor and a bankrupt each owes a debt to the other, the creditor may offset its debt against its claim against the bankrupt. 11 U.S.C. § 553. This principle is supported by "a long and venerable history, dating back to Roman and English law." *Carolco Television Inc. v. National*

Broadcasting Co., 963 F.2d 1269, 1277 (9th Cir.), *cert. denied*, 506 U.S. 918 (1992). Setoff also applies where the debtor/creditor relationship arises out of an ERISA plan's obligation to pay benefits to a participant who, in his fiduciary capacity, has incurred a debt to the plan as a result of the participant/fiduciary's breach of fiduciary duty, and then seeks to discharge the fiduciary breach debt in bankruptcy. *Parker v. Bain*, 68 F.3d 1131, 1140 (9th Cir. 1995) ("We expressly approve the district court's decision to set off the money owed *by* the Plan against the money Parker owed *to* the Plan.") (Emphasis in the original).

Similarly, the equity courts have applied the principle of setoff to a wide variety of fact patterns involving claims between trust beneficiaries, trustees, and settlors of the trust. G. Bogert and G. Bogert, *The Law of Trusts and Trustees* § 814 (Rev. 2d ed. 1981) ("Bogert on Trusts"). For example, the courts have recognized that "[a] trustee who has a duty to pay or distribute property to a beneficiary should be able to set off against the sum due (1) a debt of the beneficiary to the settlor . . ." *Id.* at § 814, pp. 291-92. Similarly, this right to assert mutual claims between settlor and beneficiary applies to claims between the trustee and the trust beneficiary. For example, where a trustee conveys the trust estate to the beneficiary without first deducting the expenses of administration from the trust corpus, the trustee may look to the beneficiary to indemnify him for the expenses of administration, but only to the extent of the value of the property given to the beneficiary. Restatement (2d) of the Law of Trusts, § 249(2) (1959); J. Pomeroy, IV *A Treatise on Equity Jurisprudence* § 1085b (5th ed. 1941). These principles, drawn from traditional trust law, demonstrate that the equity courts look beyond the pure formalism of a trust and require the parties to the trust to recognize and offset their mutual obligations to each other.

Traditional trust law principles should guide this court in formulating the rules governing the remedies available under ERISA. *Varity Corp. v. Howe*, 516 U.S. 489, 496 (1996). But the Supreme Court has cautioned that the application of traditional trust law principles must be judged against the particular characteristics of the statutory rules and policies that govern ERISA plans. "In some instances, trust law will offer only a starting point, after which court must go on to ask whether, or to what extent, the language of the statute, its structure, or its purposes require departing from common-law trust requirements." *Id.* at 497. Moreover, the courts should consider that ERISA was designed to further several purposes that to some extent are in competition. Thus, while Congress desired to enhance the protections available for employee benefits, it also "desired[d] not to create a system that is so complex that administrative costs, or litigation expenses, unduly discourage employers from offering welfare benefit plans in the first place." *Id.*

Here, ERISA's highly unusual requirement that the sponsors of defined benefit pension plans act as insurers of the plans' investment performance should guide the court in formulating the remedial doctrines that govern the relationship between sponsoring employers who act both as settlors of the plan and as plan fiduciaries. While imposing on sponsoring employers the ongoing duty to make up shortfalls in investment performance, Congress also permitted employers to prepay their liabilities, within limits, by paying more than the statutory minimum contributions. Like the installment contract debtor who prepays some of his installments, and who can use those advance payments to satisfy a new liability to the contract creditor, an employer who prepays its funding obligations by building up a credit balance should be allowed to use the credit balance to offset any additional liability that might be imposed under ERISA's fiduciary rules.

In the long run, if the plan's assets are diminished by an unwise investment choice, the employer's credit balance will be used up faster, and the employer will have to make up the difference. If the employer has already made up that difference, recognizing the employer's right to credit its advance payments against the loss will eliminate wasteful litigation and avoid "'the absurdity of making A pay B when B owes A.'" *Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16, 18 (1995) (*quoting Studley v. Boylston Nat. Bank*, 229 U.S. 523, 528))

B. Imposing liability on 3M would undermine ERISA's purposes by discouraging employers from generously funding defined benefit pension plans.

Congress enacted ERISA's minimum funding standards to ensure that when workers retire, the money will be there to pay their promised benefits. *Nachman Corp. v. Pension Benefit Guar. Corp.* 446 U.S. 359, 375-76 (1980). *C*onsistent with this objective, ERISA allows employers to pay more into the defined benefit plans that they sponsor than the minimum that the law requires. By doing so, plans become fully-funded more rapidly because they have more money earlier to invest than they would otherwise have. A rule that discourages employers from making more than the minimum required contributions will have only a deleterious effect on the funded status of plans, and overall, reduce the level of security afforded to the benefits promised under such plans.

The rule that the plaintiff-appellants advocate would have precisely this deleterious effect. If fiduciary liability can be imposed on a sponsoring employer who has prefunded its plan, then a rational employer will take either of two courses of action.

At the outset, when the employer is considering making a contribution in excess of the statutory minimum, it will recognize that the safer course is to hold back that excess contribution as a reserve against the potential of having to satisfy a judgment for fiduciary breach. While ultimately, every sponsor of a defined benefit has to foot the bill for a loss of plan assets, the funding rules allow the sponsor to amortize losses in an orderly fashion over five years. In contrast, a money judgment for fiduciary breach is payable when it becomes final, and a large judgment can have serious immediate repercussions for an employer's cash flow and operations. Hence, a rational employer, faced with even the hypothetical possibility that someday, somehow, it might be held liable for a fiduciary breach, will, if it has the money, self-insure against that risk. Under those circumstances, the plans and their participants lose out. Money that would otherwise have been paid into the plan to earn income and appreciate in value will instead remain in the corporate treasury, where, among other things, it is exposed to the claims of the employer's general creditors.

Alternatively, an employer like 3M, which has routinely funded its plan well beyond what the law requires, and who is required to satisfy a fiduciary breach judgment, will make up its loss by withholding future excess payments, until it recoups the judgment amount, along with interest and attorney's fees. Fiduciary breach litigation against employers who have the desire and wherewithal to make excess contributions to their plans will then become nothing but a timing game, with employers withholding or delaying additional contributions until they know the outcome of every actual or potential claim that the employer invested the plan's assets in an imprudent manner. Overall, the only significant effect of this scheme is to impose on employers, and ultimately on their plans, the transaction costs of fiduciary litigation.

In their brief, the appellants advance a number of arguments attacking the district court's decision to look to the existence of surplus assets in the plan as the basis for avoiding the imposition of additional liability on 3M. Brief for Appellants at 28-37. The appellants may argue that some of these arguments apply with equal force to using the employer's excess contributions to offset its liability for a fiduciary breach. But these arguments have even less force when aimed at the rule that APPWP is advocating.

The appellants argue, for example, that looking to the existence of an asset surplus injects uncertainty and speculation into the business of measuring losses arising from an imprudent investment. According to the appellants, an existing surplus may disappear over time because the plan's actual experience may be different from what is projected under its actuarial assumptions. Brief for Appellants at 31-32, 36. Whatever the merits of this argument when aimed at surplus, it has no application whatever to a rule that offsets excess contributions against fiduciary liability. Excess contributions are measurable and certain at the time they are made, and the existence of a credit balance in the plan's funding standard account can be readily ascertained by examining the plan's financial statements at the time the fiduciary breach claim is asserted. An employer either has or has not made excess contributions. There is nothing speculative or uncertain about that question.

The appellants also argue that looking to surplus violates a fundamental trust law principle that a breaching fiduciary may not offset gains from other investments against losses resulting from an improvident investment. Brief for Appellants at 33. The rule APPWP advocates could have no such effect. When the plan's assets grow, the employer's minimum funding obligation is reduced. Any excess contribution that the employer may make above the minimum represents money that the employer could have chosen not to contribute to the plan in light of its favorable investment performance. When the employer decides to make an excess contribution, the excess represents money that the plan would not have received except for the employer's voluntary choice to make the contribution.

The appellants next argue that the rule adopted by the district court "establishes unprecedented immunity for fiduciaries who are the plan sponsor," and "jeopardizes the ability of a plan to recover losses from third party wrongdoers." But as we have shown, an employer sponsor of a defined benefit pension plan never has "immunity" from the consequences of a fall in the value of the plan's assets. Ultimately, the sponsoring employer has a statutory duty to fund the promises its make in a defined benefit plan. Allowing an employer to offset its excess contributions against a fiduciary loss merely recognizes that the employer must pay the loss by diminishing the credit balance it has accumulated to satisfy future funding obligations.

By the same token, both the rule adopted by the district court and the rule advocated by APPWP, can apply only to the sponsoring employer who has the statutory duty to fund the plan. If a third party, such as an outside investment adviser, causes a decline in plan assets through an imprudent investment, the third party cannot rely on contributions it has not made to discharge its liability for a fiduciary breach. In fact, if such a third party is not held accountable for the losses it causes, the ultimate burden of the loss will fall on the plan sponsor, who must make up any shortfall in assets. Thus, there is no conceivable argument for extending either the district court's rule or the rule advocated here to third-party fiduciaries.

In sum, there are strong policy reasons that favor allowing a sponsoring employer fiduciary to offset its excess contributions against losses attributable to fiduciary breaches. Doing so will cause plans overall to be better funded and will avoid needless and wasteful litigation.

CONCLUSION

Based on the foregoing, *amicus curiae* APPWP respectfully urges the court to affirm the judgment of the district court and hold that an employer that funds the plan at a level in excess of what ERISA requires may rely on its excess payments to the plan to offset any liability it might incur as a result of a fiduciary breach.

Respectfully submitted,

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