

UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF FLORIDA
MIAMI DIVISION

THOMAS E. PEREZ,)
Secretary of Labor,)
United States Department of Labor,)
)
Plaintiff,)

FILE NO.

v.)

COMMODITY CONTROL)
CORPORATION; DAVID J. PILGER, an)
individual; the estate of WILLIAM M.)
PILGER, an individual; and COMMODITY)
CONTROL EMPLOYEE STOCK)
OWNERSHIP PLAN AND TRUST;)
)
Defendants.)

COMPLAINT
(Injunctive Relief Sought)

1. The Secretary is charged with enforcing the provisions of Title I of the Employee Retirement Income Security Act of 1974 ("ERISA"), as amended, 29 U.S.C. §§ 1001 et seq. One of ERISA's goals is to ensure "the soundness and stability of plans with respect to adequate funds to pay promised benefits." ERISA § 2(a), 29 U.S.C. § 1001(a). To protect plan investments, ERISA requires that those who manage the investments act solely, exclusively and prudently in the interests of plan participants. ERISA §§ 404(a)(1)(A) & (B), 29 U.S.C. §§ 1104(a)(1)(A) & (B). Fiduciaries must also discharge their duties in accordance with the documents and instruments governing the plan, insofar as such documents and instruments are consistent with ERISA's other fiduciary provisions. ERISA §404(a)(1)(D), 29 U.S.C. § 1104(a)(1)(D).

2. Title I of ERISA also creates *per se* prohibitions barring conflict of interest transactions between a plan and a party in interest. ERISA §§ 406-408, 29 U.S.C. §§ 1106-1108. Congress concluded that certain transactions present such grave opportunities for abuse that, except in narrowly-defined circumstances, they should be prohibited. Thus, subject to certain narrow exceptions, ERISA prohibits a fiduciary from causing a plan to engage in the sale or exchange of property between the plan and a party in interest, ERISA § 406(a)(1)(A), 29 U.S.C. § 1106(a)(1)(a); prohibits a fiduciary from dealing with the assets of a plan in his own interest or for his own account, ERISA § 406(b)(1), 29 U.S.C. § 1106(b)(1); and prohibits a fiduciary from acting in any transaction involving the plan on behalf of a party whose interests are adverse to the interests of the plan in his individual or any other capacity, ERISA § 406(b)(2), 29 U.S.C. § 1106(b)(2).

3. When ERISA's strict fiduciary standards are not met, the Secretary has the authority to seek relief under ERISA §§ 409(a) and 502(a)(2) & (5), 29 U.S.C. §§ 1109(a) and 1132(a)(2) & (5), to restore plan losses, to recover unjust profits and to obtain other remedial and equitable relief as the court may deem appropriate. The Secretary may also seek injunctions to prevent those who have violated their fiduciary duties from managing or providing services to employee benefit plans in the future.

4. Not only may fiduciaries be held directly responsible for losses and other relief for their own misconduct, but their co-fiduciaries may also be held liable for losses and other relief when those co-fiduciaries participate in, enable or fail to remedy another fiduciary's breach. ERISA §§ 405(a)(1)-(3), 29 U.S.C. §§ 1105(a)(1)-(3).

5. This case involves the sale of shares by David J. Pilger and William M. Pilger, the former owners of Commodity Control Corporation (the "Company"), to their employees

through an Employee Stock Ownership Plan (“ESOP”) for nearly twice as much as those shares were worth. For purposes of these Stock Purchases, David Pilger and William Pilger acted as trustees (“Trustees”) and the Company acted as Plan Administrator to the ESOP. The employees overpaid for the Company’s shares as a result of the Company and the Trustees’ failures to meaningfully review the valuation of the Company at the time of the Stock Purchases. Instead, the Company and the Trustees completely relied on the findings of an appraiser, but failed to ensure that the financial information provided to the appraiser and used in her valuations was accurate and complete, to read through and understand the appraiser’s valuations, to question any of the assumptions underlying those valuations, and to ensure that the valuation was up-to-date at the time of the Stock Purchases. As a result of the Company and the Trustees’ neglect of their fiduciary responsibilities in approving valuations based on the appraisers’ unsupported and unrealistic assumptions, the ESOP overpaid for shares in the Company.

JURISDICTION AND VENUE

6. This Court has jurisdiction over this action pursuant to ERISA § 502(e)(1), 29 U.S.C. § 1132(e)(1).

7. Venue with respect to this action lies in the United States District Court for the Southern District of Florida, pursuant to ERISA § 502(e)(2), 29 U.S.C. § 1132(e)(2).

PARTIES

8. The Plaintiff Secretary is vested with the authority to enforce the provisions of Title I of ERISA by, among other means, the filing and prosecution of claims against fiduciaries and other parties who commit violations of ERISA. ERISA §§ 502(a)(2) and (5), 29 U.S.C. §§ 1132(a)(2) and (5).

9. The Company is a wholesaler and exporter of dry cleaning chemicals and supplies, headquartered in Miami, Florida. The Company established the Commodity Control Employee Stock Ownership Plan (“ESOP”) on December 30, 2008, to be effective as of January 1, 2008. The Company is named in the ESOP’s Plan Documents as the Employer, Plan Sponsor and Plan Administrator to the ESOP. The Company performed its Administrator functions through its Board of Directors, which acted as functional fiduciaries to the ESOP. At the relevant times, the Board of Directors included David Pilger and William Pilger.¹ The Company itself, as Plan Administrator, is a fiduciary within the meaning of §§ 3(21)(a) and 402(a) of ERISA, 29 U.S.C. §§ 1002(21)(a) and 1102(a), and a “party in interest” within the meaning of § 3(14) of ERISA, 29 U.S.C. § 1002(14).

10. The ESOP is an employee pension benefit plan as defined in ERISA § 3(2), 29 U.S.C. § 1002(2). The ESOP is named as a defendant herein pursuant to Rule 19(a) of the Federal Rules of Civil Procedure solely to assure that complete relief can be granted.

11. Defendants David J. Pilger and William M. Pilger (collectively, the “Trustees”) were equal co-owners of the Company until they sold their shares to the ESOP in 2009. David Pilger is the Chairman/Director of the Company, and William Pilger is the Vice Chair/Director of the Company. Both David Pilger and William Pilger are named as Trustees to the ESOP, and have served in this capacity since the ESOP’s inception on January 1, 2008. The Trustees are responsible for the management and maintenance of the ESOP assets and are also required to value such assets at fair market value. Accordingly, at all relevant times, the Trustees

¹ During the relevant time, other individuals in addition to David Pilger and William Pilger have also served on the Company’s Board of Directors; however, the evidence does not indicate that any of these individuals actively participated in the operation or administration of the ESOP.

are and have been fiduciaries to the ESOP, within the meaning of §§ 3(21)(a) and 402(a) of ERISA, 29 U.S.C. §§ 1002(21)(a) and 1102(a).

12. Defendants David Pilger and William Pilger, as the co-owners of the Company, the sellers of shares to the ESOP, fiduciaries of the ESOP, and officers or directors of the employee benefit plan or its sponsor are parties in interest pursuant to ERISA § 3(14), 29 U.S.C. § 1002(14).

13. Upon information and belief, Defendant William Pilger is deceased and this action is brought against his estate.

GENERAL ALLEGATIONS

14. David Pilger and William Pilger, the co-owners of the Company at all times until January 2009, began looking into how to divest themselves of their ownership stake in the Company and exit from the business. The Pilgers subsequently looked into selling the Company to its employees using an ESOP.

15. On September 26, 2008, David Pilger hired RSM McGladrey Inc. (“McGladrey”), an independent consulting firm, to perform an appraisal of the fair market value of a 100% interest in the Company, for purposes of establishing an ESOP. On December 10, 2008, McGladrey issued its Appraisal Report, prepared by Tracy A. Lamb, ASA. The Appraisal Report concludes that as of June 30, 2008, the FMV of 100% of the Company Stock was \$9,677,000 (rounded), before adjustment for lack of marketability. After the application of a median 5% marketability discount, the Appraisal Report concluded that the value of a 100% interest in the Company Stock as of June 30, 2008 was \$9,193,000 (or, \$22.75 per share) on a control, non-marketable basis.

16. On January 22, 2009, Defendants caused the ESOP to purchase **22,000** shares of Commodity Control common stock from Defendants William Pilger and David Pilger for **\$22.75** per share or a total of **\$500,500**. Such purchase price was based upon the Appraisal Report by RSM McGladrey, with a date of valuation of June 30, 2008.

17. On February 22, 2009, Defendants caused the ESOP to enter into a Stock Purchase Agreement and Pledge Agreement under which it purchased **378,000** shares of the common Stock of Commodity Control from Defendants William Pilger and David Pilger for **\$22.75** per share or a total of **\$8,599,500** representing the balance of 100% of the issued and outstanding shares of the Company. Such transaction price was again based on the Appraisal Report issued by RSM McGladrey. At the time of the second Stock Purchase, the ESOP made a cash payment on closing of **\$15,783** from funds in the ESOP Trust; the remainder of the Stock Purchase was financed by Promissory Notes from the ESOP to the Trustees/Defendants totaling **\$8,583,717**. These Promissory Notes are collateralized by the unallocated shares of Company Stock and require the ESOP to make monthly payments of principal and interest² over a ten (10) year term, with any unpaid balance due at the end of such period.

18. Section 6.05(e) of the ESOP Document specifies that, “in the event of default of a loan, the value of Trust Fund Assets transferred in satisfaction of the loan must not exceed the amount of the default.” Further, section 6.05(d) of the ESOP Document states that the “liability of the Trust Fund for repayment of the loan must be limited to collateral given for the loan.”

19. Contrary to these terms of the ESOP Document, the Promissory Notes securing the loan between the Trustees and the ESOP, dated March 1, 2009, provide that in the

² Initially, the Promissory Notes required interest payments of 4% per annum. As of January 1, 2012, the Notes were amended so that the rate of interest is 1.4% per annum.

event of default, the ESOP will pay the cost of collection and attorney fees. Further, the Promissory Notes state that they “shall immediately become due and payable” in the event of default “or in the payee deems or has reasonable cause to deem himself insecure.”

20. On December 7, 2009, nearly ten months after the second Stock Purchase, Ms. Tracy Lamb provided a one page letter to the Trustees (“Fairness Opinion”), opining that “no alteration of value [from the previous valuation of \$22.75 per share as of June 30, 2008] was warranted as of February 18, 2009.” In the Fairness Opinion, Ms. Lamb claims to have considered “all relevant factors” and to have “discussed with management the changes in financial performance and position between the June 30, 2008 valuation date and February 18, 2009, as well as management’s outlook.” She claims to have found “no material changes in financial performance or position... which would result in a lower value for ESOP transaction purposes.”

21. Over the next several years, the Company made contributions to the ESOP in excess of \$2.8 million, which the ESOP has used to pay interest on the Promissory Notes and to release shares, which were allocated to all eligible Participant Accounts. As of December 31, 2014, the ESOP had an outstanding loan balance of \$7,302,526. At that time, the ESOP had 62 participants.

22. Defendants, as fiduciaries and Trustees to the ESOP, failed to completely read and understand the Appraisal Report issued by McGladrey. Their failure to adequately review McGladrey’s valuations included failing to ensure that the financial information contained in the valuations was accurate at the time of the Stock Purchases. In addition, Defendants never understood the underlying assumptions in the valuation reports or the effect of these assumptions on the resulting valuations. As a result, they were unable to – and did not – question any of

McGladrey's assumptions regardless of how unsubstantiated or unrealistic those assumptions were.

23. Defendants lacked understanding of the various possible valuation methods, including those used by McGladrey, and why or whether certain methods were more or less appropriate for determining the Company's fair market value.

24. McGladrey's valuation was unreliable and grossly inflated the value of the Company's shares. The valuations contained numerous flaws, none of which was spotted or questioned by Defendants. McGladrey's Appraisal Report did not include the necessary business or industry research, accurate financial information, or analysis and realistic projections that specifically took into account the circumstances of the Company and its industry.

25. Had Defendants bothered to actually read, understand, and analyze McGladrey's Appraisal Report, they would have found significant flaws in his reports, including, but not limited to:

- a. Improper inclusion of 2008 cash flow in the computation of present value of future net cash flows;
- b. Failure to update the valuation to consider the issuance, on February 18, 2009, of Common Stock warrants to the Selling Shareholders;
- c. Overly aggressive cash flow projections;
- d. Low weighted average cost of capital rate;
- e. High long term growth rate;
- f. Low capitalization rate;
- g. Improper/questionable adjustment to earnings; and
- h. Failure to update valuation as of the dates of Stock Purchases.

26. The ESOP's governing plan documents required the Trustees to, among other things, determine the fair market value of the ESOP assets and to determine the prudence of the ESOP's investments.

27. Defendants completely relied on the conclusions found in McGladrey's Appraisal Report for the Stock Purchases that they approved in January and February 2009.

28. As a result of Defendants' approval of McGladrey's Appraisal Report for both of the ESOP's Stock Purchases, Defendants authorized the ESOP to significantly overpay themselves – David J. Pilger and William M. Pilger – for the Company's stock.

COUNT I

**The ESOP Transactions – Imprudence, Disloyalty, and
Failure to Comply with Plan Documents -
ERISA §§ 404(a)(1)(A), (B), and (D).**

29. Paragraphs 1 through 28 are incorporated herein as though fully set forth.

30. Defendants the Company, David Pilger, and William Pilger, as fiduciary and Trustees of the ESOP, breached their fiduciary duties to the ESOP to act solely in the interest of the participants and beneficiaries with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, in violation of ERISA §§ 404(a)(1)(A) & (B), by, among other things:

- a. Relying on the conclusions in McGladrey's Appraisal Report and Fairness Opinion without providing McGladrey with complete and accurate information and without making certain that reliance on McGladrey's advice was reasonably justified under the circumstances.

- b. Causing the ESOP to approve the purchase of the Company's stock from the Trustees at a price in excess of fair market value on both occasions.

31. Defendants failed to determine the prudence of the ESOP's investments as required by the ESOP's plan document and failed to ensure that the Promissory Notes issued by the ESOP conformed to the requirements of the ESOP's plan document, both in violation of ERISA § 404(a)(1)(D), 29 U.S.C. § 1104(a)(1)(D).

32. As a result of the foregoing breaches of fiduciary duty, Defendants caused a loss to the ESOP for which they are personally liable. ERISA § 409(a), 29 U.S.C. § 1109(a).

33. As set forth above, as ESOP fiduciaries, the Company, David Pilger, and William Pilger (a) participated in the other's breach of duty, (b) enabled the other to breach his duties relating to the transactions, (c) knew or should have known of the other's breaches of fiduciary duty and failed to take action regarding the transactions, and (d) failed to make reasonable efforts under the circumstances to remedy those breaches of duty. ERISA §§ 405(a)(1)-(3), 502(a)(2) & (5), 29 U.S.C. §§ 1105(a)-(3), 1132(a)(2) & (5).

34. The ESOP's assets were controlled by the Company, David Pilger, and William Pilger at all times, making each responsible for the other's failure to use reasonable care to prevent his co-trustee from committing a breach. Accordingly, the Company, David Pilger, and William Pilger are also liable as co-fiduciaries for the losses caused by any fiduciary. ERISA §§ 405(b)(1)(A), 502(a)(2) & (5), 29 U.S.C. §§ 1105(b)(1)(A), 1132(a)(2) & (5).

35. Defendants also violated their fiduciary duties to exercise their responsibilities solely in accordance with the documents and instruments governing the ESOP insofar as such documents and instruments are consistent with Title I of ERISA in violation of ERISA

§ 404(a)(1)(D), 29 U.S.C. § 1104(a)(1)(D), by failing to ensure and determine the prudence of the ESOP's investments and by causing the ESOP to issue Promissory Notes with terms contrary to those required by the plan document.

COUNT II

**The ESOP Transactions – Prohibited Transactions
ERISA §§ 406(a)(1)(A), (B), and (D)**

36. Paragraphs 1 through 35 are incorporated herein as though fully set forth.

37. By authorizing the ESOP to purchase shares of the Company stock for greater than “adequate consideration” (defined as the “fair market value of the asset as determined in good faith by the trustee or named fiduciary”), ERISA § 408(e), 29 U.S.C. 1108(e); ERISA § 3(18)(B), 29 U.S.C. 1002(18)(B), Defendants engaged in a non-exempt prohibited transaction under ERISA § 406(a)(1)(A), 29 U.S.C. § 1106(a)(1)(A), by causing the ESOP to engage in a transaction that they knew or should have known was a direct sale of property between the plan and a party in interest.

38. By authorizing the ESOP to accept a loan from David Pilger and William Pilger in order to finance the Stock Purchase, Defendants engaged in a non-exempt prohibited transaction under ERISA § 406(a)(1)(B), 29 U.S.C. § 1106(a)(1)(B), by causing the ESOP to engage in a transaction that they knew or should have known was a lending of money or other extension of credit between the plan and a party in interest.

39. By authorizing the ESOP to provide Company Stock to David Pilger and William Pilger as collateral for the Promissory Notes financing the Stock Purchase, Defendants engaged in a non-exempt prohibited transaction under ERISA § 406(a)(1)(D), 29 U.S.C.

§ 1106(a)(1)(D), by causing the ESOP to engage in a transaction that they knew or should have known was a transfer to, or use by or for the benefit of, a party in interest, of any assets of the plan.

40. As a result of the foregoing prohibited transactions, Defendants David Pilger and William Pilger, received property, cash, or proceeds from the ESOP as part of the sale or exchange of ESOP shares from them to the ESOP, which they must restore to the ESOP under ERISA § 502(a)(5), 29 U.S.C. § 1132(a)(5).

41. As a result of the foregoing prohibited transactions, Defendants caused a loss to the ESOP for which they are jointly and severally liable. ERISA § 409(a), 29 U.S.C. § 1109(a).

COUNT III

The ESOP Transactions – Prohibited Transactions - 406(b)(1) & (2)

42. Paragraphs 1 through 41 are incorporated herein as though fully set forth.

43. Defendants David Pilger and William Pilger, in their capacities as Trustees, engaged in transactions between the ESOP and themselves, the sellers of Company shares, prohibited by ERISA and in violation of:

- a. ERISA § 406(b)(1); 29 U.S.C. § 1106(b)(1) prohibiting them from dealing with the assets of the ESOP in their own interest and for their own account;
- b. ERISA § 406(b)(2); 29 U.S.C. § 1106(b)(2) prohibiting them from acting in any transaction involving the plan on behalf of a party whose interests are adverse to the interests of the plan in their individual or any other capacity.

44. As a result of the foregoing breaches of fiduciary duty and prohibited transactions, Defendants David Pilger and William Pilger caused a loss to the ESOP for which each is personally liable. ERISA § 409(a), 29 U.S.C. § 1109(a).

PRAYER

WHEREFORE, the Secretary of Labor prays that this Court enter an Order:

1. Requiring each of the fiduciary Defendants involved with the ESOP Stock Purchases – the Company, David Pilger, and William Pilger, jointly and severally – to restore all losses caused to the ESOP as a result of their fiduciary breaches in connection with these transactions;

2. Requiring David Pilger and William Pilger to disgorge any cash, payments, or proceeds that they received for any of the ESOP Stock Purchases;

3. Permanently enjoining all Defendants from serving as fiduciaries or service providers to ERISA plans in the future;

4. Granting such other relief as may be equitable, just and proper.

Respectfully submitted this 20th day of January, 2016.

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