UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

No. 91-2452

CERTAIN DENKA ESOP PARTICIPANTS,

Plaintiffs-Appellants,

versus

MARVIN Z. WOSKOW, ET AL.,

Defendants-Appellees.

Appeal from the United States District Court
For the Southern District of Texas
(CA H 89 2255)

(November 25, 1992)

Before POLITZ, Chief Judge, SMITH and BARKSDALE, Circuit Judges.

POLITZ, Chief Judge:[*]

Contending that the management of Denka Chemical Corporation shortchanged them in its design of an Employee Stock Ownership Plan, approximately 300 plan participants appeal an adverse judgment following a bench trial. Concluding that the Employee

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[*]Local Rule 47.5 provides: "The publication of opinions that have no precedential value and merely decide particular cases on the basis of well-settled principles of law imposes needless expense on the public and burdens on the legal profession." Pursuant to that Rule, the Court has determined that this opinion should not be published.

Retirement Income Security Act[1] is inapplicable, and that plaintiffs' state law claims are time-barred, we affirm.

Background

Denka, a manufacturer of neoprene rubber and maleic anhydride products, had been losing money for several years when its Japanese owner, Denka Kagaku Kogyo Kabushiki Kaisha (Denka-Japan), decided to either sell the company or close it. At the time, the company had a negligible appraised value. After efforts to find a buyer failed, Marvin Woskow, then executive vice-president, proposed a leveraged buyout by management, accompanied by a 25 percent reduction in employee wages and benefits and the establishment of an Employee Stock Ownership Plan (ESOP). According to a feasibility study prepared by Kelso & Co., the investment advisor engaged by Woskow, the ESOP "serves a vital purpose in the transaction because large ESOP contributions are what employees receive in exchange for significant cash savings generated as a result of required salary and wage cuts and termination of the pension plans."

With Denka-Japan receptive to the idea and other management personnel on board, Woskow made his proposal known to the employees, including through slide show presentations. Collective bargaining about the concessions and the ESOP ensued. The membership of the Oil, Chemical and Atomic Workers International

[1] 29 U.S.C. § 1001 et seq.

Union, the largest of the plant's four unions, initially rejected the proposal by a wide margin. But after receipt of 60-day layoff notices and negotiation of a severance package for those who chose to resign, the employees did a 180-degree turn and approved the proposal. A week later, on March 9, 1984, the sale closed.

Under the terms of the sale, 13 management personnel, called "the founders," together with an affiliate of Kelso, purchased all outstanding shares of Denka for an investment of $270,000. This represented a cost of $3 a share. Denka-Japan also received $5 million in borrowed cash, secured by Denka assets, and a $28 million non-recourse note, representing half of the depreciated book value of the company's assets plus interest. In return, Denka-Japan canceled $30 million in intercompany loans and agreed to pay more than $9 million in other Denka obligations.

Immediately after the sale, Denka's new Board of Directors, Woskow and Marshall Kendrick, adopted the ESOP, effective April 1, 1984. As previously agreed, the ESOP provided for stock contributions to each employee's account at the end of the fiscal year. The contributions were to equal 25 percent of the employee's base pay, translated into shares on the basis of a current independent appraisal of the value of the stock.

At the end of the first fiscal year, March 31, 1985, Denka was appraised at $18 million, resulting in a value of $177.36 per share. Denka contributed 9,419 shares to the ESOP and the founders sold the ESOP another 1,070 shares. On March 31, 1986, the ESOP

received 4,925 shares, appraised at $407.06 apiece. With the company prospering, during 1986 all wages and holidays were restored to pre-concession levels. On March 31, 1987, Denka contributed 4,624 shares to the ESOP. These shares were appraised at $489.90. In January, 1988, with ESOP participant approval, Denka was sold to Mobay Corporation for $63.1 million. This tallied to $558.16 per share. At the time of sale, the ESOP held 20.5 percent of the stock, entitling its participants to approximately $13 million. The founders and the Kelso affiliate received approximately $50 million.

Dissatisfied with receiving what they considered to be an inequitably small share of the sale proceeds, 300 or so ESOP participants filed the instant suit on July 5, 1989, claiming that the founders had violated their fiduciary duties under ERISA. Plaintiffs also asserted several state law claims, most notably a claim for fraudulent inducement and a federal securities fraud claim. After a bench trial on the ERISA count, the district court found for the defendants. It also held that the state law claims were preempted and that plaintiffs had failed to state a securities fraud claim. Plaintiffs timely appealed.

Analysis

1. ERISA Claim

Plaintiffs do not dispute that Denka delivered to the ESOP, as promised, shares equal to 25 percent of the base payroll. Rather, they contend that the 1984 sale was inherently unfair to them and

that the founders violated their fiduciary duties under ERISA by involving the ESOP without the benefit of independent financial advice. The district court rejected this claim, correctly finding no fiduciary duty at the time of the sale because the ESOP did not come into existence until after the sale. It was not until after the sale that the founders had authority to establish the plan.[2] Plaintiffs contend that this analysis is overly formalistic, ignoring the substance of the transaction. We disagree. Plaintiffs blur the substance of the transaction by characterizing a complaint about the design of the ESOP as one about the structure of the sale.

The purchase from Denka-Japan was a management buyout. The ESOP by its terms gave its participants no equity at the time of purchase but rather the prospect of obtaining stock at the end of each fiscal year. By investing up front, the founders obtained their shares at $3. The ESOP participants, on the other hand, did not receive stock until a year later, when shares were appraised for $177. Thereafter, the Denka stock continued to climb in value. As a result, the ESOP participants owned a smaller proportion of the company's stock and thus were entitled to a smaller share of the proceeds from the Mobay sale.

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[2] 29 U.S.C. § 1002(2)(A); see also, **Donovan v. Dillingham**, 688 F.2d 1367 (11th Cir. 1982) (en banc) (only an employer or employee organization or both may establish an employee benefit plan); **Landry v. Air Line Pilots Ass'n Int'l. AFL-CIO**, 901 F.2d 404 (5th Cir. 1990) (no fiduciary obligation arises during the negotiation or execution of an agreement regarding future pension benefits), cert. denied, ___ U.S. ___, 111 S.Ct. 244, 112 L.Ed. 2d 203 (1990).

Plaintiffs maintain that the founders should have given them a more generous plan. ERISA, however, "does not mandate that employers provide any particular benefits."[3] "Decisions as to whether or when to establish a plan, or how to design a plan, are not subject to any ERISA fiduciary obligation."[4] Accordingly, ERISA affords no relief for this particular complaint.

2. State Law Claims

The district court dismissed as preempted by ERISA the plaintiffs' state law claims. We do not reach the preemption issue because we find those claims time-barred.[5]

Actions for fraudulent inducement and stock transaction fraud[6] must be commenced within four years after the fraud is perpetrated.[7]

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[3] **McGann v. H & H Music Co.**, 946 F.2d 401, 406 (5th Cir. 1991) (quoting **Shaw v. Delta Air Lines, Inc.**, 463 U.S. 85, 91, 103 S.Ct. 2890, 77 L.Ed. 2d 490, 497 (1983)), cert. denied, 61 U.S.L.W. 3352, 1992 WL 24317.

[4] **Landry**, 901 F.2d at 414.

[5] We may affirm the district court's judgment on any grounds supported by the record. **Sojourner T. v. Edwards**, 974 F.2d 27 (5th Cir. 1992).

[6] Tex.Bus. & Com.Code § 27.01.

[7] **Williams v. Khalaf**, 802 S.W. 2d 651 (Tex. 1990) (limitations period for fraud is four years); **Wood v. Combustion Engineering, Inc.**, 643 F.2d 339 (5th Cir. 1981) (limitations period for fraud applies to securities fraud claims brought under section 27.01 of the Texas Business and Commerce Code).

> If, however, the injured party is not aware of the fraud or the fraud is concealed, the statute of limitations begins to run from the time the fraud is discovered or could have been discovered by the defrauded party's exercise of reasonable diligence. Knowledge of facts that would lead a reasonably prudent person to make inquiry which would lead to a discovery of the fraud is knowledge of the fraud itself.[8]

Plaintiffs filed suit on July 5, 1989. Unless they did not or reasonably would not have discovered the alleged fraud until July 5, 1985, their claims are prescribed.

The gravamen of these claims is that the founders fraudulently induced plaintiffs to accept wage and benefit cuts by the promise of employee ownership and ultimate control, when in fact the rising value of the company impeded employee acquisition of control. Plaintiffs, however, had sufficient information about the structure of the 1984 sale to know how the ESOP was to be fashioned and how their ownership would accrue. In the December 1983 slide shows, Woskow informed Denka employees that the founders were seeking to buy the company. He explained that the founders were investing "several hundreds of thousands of dollars," that Kelso also was investing, and that a "multi-million dollar" loan and a long-term note would comprise the balance of the purchase price. With respect to the proposed ESOP, he stated that the company would contribute stock in an amount equal to 15 to 25 percent of each

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[8] **Jackson v. Speer**, 974 F.2d 676, 679 (5th Cir. 1992) (citations omitted).

employee's base pay[9] at the end of each year. He illustrated how an increase in the value of the stock would reduce the number of shares contributed, and he estimated that the employees would acquire a controlling interest in the company in six to eight years. Finally, Woskow projected that the company would grow in value.

At the same time, press releases announcing negotiations for a management buyout were issued, published, and posted on bulletin boards. James Mooney, chair of the OCAW negotiating committee, testified that he told his membership during union meetings that management was purchasing the company and he predicted that "if anybody was going to get rich off the deal, it would be the original purchasers." The matter was an open book for any inquiring eye.

The founders made the terms of the ESOP known. The information conveyed was sufficient to notify plaintiffs that the company likely would appraise for more than the founders' "several hundred thousand dollar" investment, that ESOP stock necessarily would have a higher value than the price paid by the founders, and that shares issued at a higher value would mean a proportionately smaller ownership percentage. If plaintiffs were uncertain about any of the implications of Woskow's slide presentation, they should have made further inquiry. We conclude that their cause of action accrued more than four years before suit was filed.

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[9] Soon after, the founders settled on the 25 percent figure for the first three years of operation.

The same result obtains with respect to the claims for breach of contract and breach of fiduciary duty. The limitations periods began in 1984 and expired before suit was filed.[10]

3. Federal securities fraud claim

We likewise find the federal securities fraud claim prescribed. We borrow the Texas four-year statute of limitations for common law fraud in the absence of a limitations period in section 10(b) of the Securities and Exchange Act of 1934.[11] Like the Texas rule, federal law provides that the cause of action begins to accrue with either actual knowledge of the violation or notice of facts which, in the exercise of due diligence, would have

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[10] The parties agree that the longest applicable limitations period is four years. Like the fraud claims, these claims also are subject to the discovery rule and therefore accrue either when the breach occurs or when the claimant has notice of facts sufficient to place one on notice of the breach. **Rose v. Baker & Botts**, 816 S.W. 2d 805 (Tex.App. -- Houston [1st Dist.] 1991, writ denied); **El Paso Assoc., Ltd. v. J.R. Thurman & Co.**, 786 S.W. 2d 17 (Tex.App. -El Paso 1990).

[11] **Sioux, Ltd., Securities Litigation v. Coopers & Lybrand**, 914 F.2d 61 (5th Cir. 1990). The Supreme Court recently decided that the applicable statute of limitations for section 10(b) actions is one year after discovery or three years after the violation, as provided in the original remedial provisions of the 1934 Act. **Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson**, ___ U.S. ____, 111 S.Ct. 2773, 115 L.Ed. 2d 321 (1991). Congress, however, provided that state law would determine the limitations period for cases filed prior to the June 20, 1991 decision in **Lampf**. 15 U.S.C. § 78aa-1(a); **Topalian v. Ehrman**, 954 F.2d 1125 (5th Cir.), cert. denied, ___ U.S. ___, 113 S.Ct. 82 (1992). As noted, the instant action was filed July 5, 1989.

led to actual knowledge thereof."[12] This claim is time-barred for the same reason as the state law claims.

AFFIRMED.

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[12] **Vigman v. Community National Bank & Trust Co.**, 635 F.2d 455, 459 (5th Cir. 1981).