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# Credit Union Attorney

## Law Letter

A Law Letter for Credit Unions, Financial Institutions, and Attorneys

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## Retirement Plan Does Not Violate ERISA By Excluding Hourly Employees

In *Bauer v. Summit Bancorp*, No. 01-3624 (3d Cir. Mar. 25, 2003), the Third Circuit Court of Appeals held that employers with retirement plans can limit eligibility to participate in the plans to salaried employees, excluding hourly employees from eligibility. Such conduct does not violate the Employment Retirement Income Security Act of 1974, 29 U.S.C. §§ 1001 *et seq.* ("ERISA").

### Facts

John Bauer worked as a Summit Bancorp sales representative for 22 years, from May 1977 to July 1999. For the first 18-and-a-half years, Bauer was compensated on an hourly basis, to accommodate his schedule as a firefighter. For the last 3-and-a-half years, he was compensated on a salaried basis.

When he retired, Bauer applied for retirement benefits under a plan that Summit had implemented in 1980. He learned at that time that he was eligible for

benefits for only the 3-and-a-half years that he was a salaried employee. His 18-and-a-half years of service as an hourly employee counted only in satisfying the plan's 5-year vesting period.

Specifically, Summit's plan defined the term "Employee" as "any person who is ... compensated by a weekly, monthly, or annual salary, regardless of the number of hours worked." Plans like Summit's, which limit eligibility to salaried employees are commonly referred to as "salaried-only plans."

### Suit

After Summit denied him benefits for the first 18-and-a-half years of service, Bauer sued arguing that Summit's retirement plan violated ERISA. The only authority for his argument was an unpublished decision from the Southern District of New York, styled *Ambris v. Bank of New York* (1997). In *Ambris*, the court denied a motion to dismiss a claim filed by an hourly employee arguing that the Bank of New York's salaried-only plan violated ERISA.

The district court in this case, rejected *Ambris* and entered a judgment for Summit, reasoning that nothing in ERISA prevent employers from implementing

salaried-only retirement plans. Bauer appealed.

### Appeal

The Third Circuit affirmed the lower court's decision to enter a judgment for Summit. The court reasoned as follows:

"Nothing in ERISA requires employers to establish employee benefit plans. ... Neither does it require that every employee is entitled to participate in a plan that it does decide to offer. ... 'ERISA does not mandate that employers provide any particular benefits, and does not itself proscribe discrimination in the provision of employee benefits. ...'"

"...."

"The only limitation imposed by ERISA on any of the requirements for participation is entitled 'Minimum Participation,' and is set forth in 29 U.S.C. § 1052(a). It states: 'No pension plan may require, as a condition of participation in the plan, that an employee complete a period of service with the employer ... extending beyond the later of the following dates: (i) the date on which the employee attains the age of 21; or (ii) the date on which [the employee] completes 1 year of service.'"

The court found nothing in 29 U.S.C. § 1052 that prevented an employer from excluding hourly employees from a benefit plan.

The court also looked beyond ERISA, to sections of the Internal Revenue Code that are similar to ERISA. There it found support for employer's salaried-only benefit plans. 26 U.S.C. § 401(a)(5)(A) states: "A classification limiting plan coverage to salaried or clerical employees shall not, for that sole reason, be considered discriminatory."

Finally, the Third Circuit concluded that hourly employees were analogous to leased employee. The Fourth, Fifth, Tenth, and Eleventh Circuit have all considered whether ERISA prohibits employers from excluding leased employees from a benefit plan and

have held that it does not. The Third Circuit held that it was adopting the reasoning of those circuits for hourly employees.

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## **Bank Can Pay Mortgage Broker Yield Spread and Service Release Premiums that Result in Broker Receiving More Than 1% Origination Fee**

In *Bjustrom v. Trust One Mortgage Corp.*, no. 01-36706 (9th Cir. Mar. 20, 2003), the Ninth Circuit held that neither a Federal Housing Administration (FHA) regulation, nor the Real Estate Settlement Procedures Act, 12 U.S.C. §§ 2601 & 2607 ("RESPA") prevented a bank from paying a mortgage broker a yield spread and service release premium that resulted in the broker receiving more than a 10% origination fee, so long as the payments were for services actually performed by the broker.

### Facts

Mary Bjustrom entered into an agreement with Mortgage Specialists, Inc., a mortgage broker, to obtain for her an FHA loan of \$140,542 at an 8% rate of interest. Mortgage Specialist obtained the loan from Trust One, of Irvine, California, a mortgage lending institution.

Bjustrom paid Mortgage Specialist a 1% origination fee in connection with the loan. Also, in connection with the loan, Trust One paid Mortgage Specialists a \$703 yield spread premium ("YSP") and a \$1,787 service release premium ("SRP").

### Suit

Bjustrom later sued Trust One over the YSP and SRP it paid to Mortgage Specialist. She asserted that Trust One's action violated an FHA regulation and

RESPA.

### **Claim Based on FHA Regulation**

Pointing to 24 C.F.R. § 203.27(a)(2)(i), an FHA regulation, Bjustrom argued that it prohibited a mortgage lender from collecting from a borrower an amount greater than 1% of the mortgage amount. Section 203.27 states:

“(a) The mortgagee may collect from the mortgagor the following charges, fees or discounts:

“ ...

“(2) A charge to compensate the mortgagee for expenses incurred in originating and closing the loan, the charge not to exceed:

“(i) \$20 or one percent of the original principal amount of the mortgage ... whichever is greater.”

24 C.F.R. § 203.27(a)(2)(i).

The district court rejected Bjustrom's arguments based on this FHA regulation because its plain language applies only to fees collected by a mortgage lender (here Trust One) from a borrower (here Bjustrom). The court reasoned that the YSP and SRP were amounts collected by Mortgage Specialist from Trust One.

### **Claim Based on RESPA**

Like many recent borrowers, Bjustrom argued that Trust One's payment of a YSP and a SRP to Mortgage Specialists violated RESPA, which prohibits lenders from giving kickback or referral fees to brokers and others. Section 8(c) of RESPA states:

"Nothing in this section shall be construed as prohibiting (1) the payment of a fee ... (C) by a lender to its duly appointed agent for services actually performed in the making of a loan, [or] (2) the payment to any person of ...

compensation or other payment for services actually performed.

12 U.S.C. § 2607(c). The federal Department of Housing and Urban Development ("HUD") has issued two policy statements on the subject of RESPA and YSPs, stating that YSPs are not *per se* illegal. HUD's second policy statement, issued March 1, 1999, set out a two-part test to use in determining whether a YSP violates RESPA. A court must consider: "(1) whether goods or facilities were actually furnished or services were actually performed for the compensation paid"; and (2) "whether the payments are reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed." 64 Fed. Reg. 10080 at 10084.

In this case the district court found that the undisputed evidence showed that Mortgage Specialists had "provided Bjustrom with a host of compensable goods, facilities, and services that contributed to the transaction." Also, Bjustrom offered no evidence "that her mortgage broker's services weren't worth what it was paid," including the YSP, the SRP, and the origination fee.

Concluding that Bjustrom could not succeed on either claim against Trust One, it entered a judgment in favor of Trust One.

### **Appeal**

Bjustrom appealed and the Ninth Circuit affirmed the lower court's judgment.

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## **No Bad Faith in Defaulting Tenant's Use of Bankruptcy Code to Limit Rent Owed Landlord**

*In re PPI Enterprises (U.S.), Inc. (Solow v. PPI Enterprises (U.S.), Inc., no. 01-4140 (3rd Cir.*

Mar. 28, 2003), the Third Circuit has affirmed a bankruptcy court's holding that a tenant who vacated a premises before the term of its lease expired was not acting in bad faith by filing a Chapter 11 bankruptcy petition, even if its motive for doing so was solely to limit the amount of damages the landlord could collect.

### **Facts**

Sheldon Solow ("the Landlord") owned an office tower in Manhattan, New York. In August 1989, he leased a 10,000-square-foot space to PPI Enterprises ("the Tenant"). The lease had a 10-year term. The annual rent for the first 5 years was \$620,000 and the last 5 years was \$650,000. As a security deposit, the Landlord required the Tenant to obtain a letter of credit payable to the Landlord in the amount of \$650,000.

Two years into the lease, the Tenant vacated the premises and ceased paying rent. The Landlord issued a notice of default and the Tenant failed to cure that default. Thereafter, the Landlord drew on the letter of credit until it was exhausted.

In October 1991, the Landlord filed suit against the Tenant seeking to collect the balance of the rent owed, by that time \$4.7 million. The trial court entered a judgment for the Landlord but did not determine damages. The parties attempted unsuccessfully to settle the case. In March 1996, the Landlord asked the trial court to set a hearing to decide damages. On the eve of the damage hearing, the Tenant filed a Chapter 11 bankruptcy petition.

### **Chapter 11 Bankruptcy Proceeding**

Section 502(b)(6) of the Bankruptcy Code caps a landlord-creditor's damages resulting from the debtor's termination of a real property lease at the greater of: (1) one year of rent, or (2) 15 percent of the rent for the remaining lease term, but not more than three-years

worth of rent. The cap operates from the earlier of the filing date for the bankruptcy petition or the date the landlord repossessed the premises.

When the Tenant filed its bankruptcy petition, it was in the midst of liquidating and winding up its affairs, it had no ongoing business operations, one remaining employee, and no assets other than stock representing a 2% interest in Del Monte Foods Company.

Given these facts, the Landlord objected to the Tenant's Chapter 11 bankruptcy petition and plan on the ground that the bankruptcy was a sham designed for no purpose other than to avoid paying the Landlord rent because, in bankruptcy, the Landlord's rent would be capped by section 502(b)(6).

The Tenant responded that it was a legitimate use of the Bankruptcy Code to reduce the rent owed to the Landlord and that the Landlord should have no vote in whether the court should approve its bankruptcy plan, because the Landlord's rights were not impaired by the plan.

The bankruptcy court agreed with the Tenant and held that it was not bad faith for the Tenant to file for bankruptcy solely to obtain the rent cap and that, because the Bankruptcy Code's cap, not the Tenant's bankruptcy plan, was the only impairment to the Landlord's right to claim rent for the remainder of the 10-year term, the Landlord had no vote in whether to approve the Tenant's bankruptcy plan. Because of the bankruptcy filing and the cap of section 502(b)(6), the Landlord's claim for rent was reduced from \$4.7 million to just over \$100,000. The Landlord appealed.

### **Appeal**

On appeal, the Third Circuit affirmed the bankruptcy court in all respects.

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