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BENEFITS BRIEF

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Post-Dudenhoeffer Company Stock Litigation

Not surprisingly, stock drop litigation is on the rise. Plaintiffs are now challenging fiduciaries of defined contribution plans that were maintained by employers whose prospects were allegedly so bleak as to have rendered the investment in the companies' stocks by the plans imprudent under section 404 of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). Of course, these latest actions are on the heels of the U.S. Supreme Court decision in *Fifth Third Bancorp. v. Dudenhoeffer* (134 S. Ct. 2459 (2014)).

In *Dudenhoeffer*, the Supreme Court held that ERISA provides no "presumption of prudence" for company stock funds. The Court explained that, while ERISA's diversification requirement does not apply to company stock funds, ERISA's standard of prudence otherwise applies to the offering of a company stock fund as it applies to other plan investments. The Court went on to say, however, that a claim based on a publicly-traded stock being overvalued is generally "implausible" absent a showing of "special circumstances."

Kodak – Denial of Motion to Dismiss

On December 17, 2014, the U.S. District Court for the Western District of New York allowed various claims of breach of fiduciary duty to proceed against the fiduciaries (including the directed trustee) of Kodak's defined contribution plan. *Gedek v. Perez*, No. 6:12-cv-651 (W.D.N.Y.). The plan included a Kodak stock fund as an available investment option and also included an employee stock ownership plan ("ESOP") component that invested in Kodak stock. In concluding that the plaintiffs stated a plausible claim that defendants violated their duty to act prudently by continuing to permit investments in Kodak stock — or, as to the ESOP, continuing to invest in Kodak stock — the Court noted that the plaintiffs alleged that the fiduciaries "knew or should have known that Kodak's financial condition was poor, that its long-term prospects were not good, and that as a result, its stock price was going to continue to decline, which it in fact did." The Court distanced itself from *Dudenhoeffer* on the basis that *Dudenhoeffer* did not address "allegations that a company's downward path was so obvious and unstoppable that, regardless of whether the market was 'correctly' valuing the stock, the fiduciaries should have halted or disallowed further investment in it." The Court stated that "[t]he complaint recites a history not just of Kodak's inexorable slide toward bankruptcy, but of publicly available information contemporaneously documenting that slide, step by painful step, and accurately forecasting Kodak's bleak future."

RadioShack - Complaint

In a November 26, 2014 complaint filed in the U.S. District Court for the Northern District of Texas, a former employee of RadioShack alleged that various fiduciaries of RadioShack's 401(k) plan and a Puerto Rico plan (collectively, the "Plans") violated their fiduciary duties

under ERISA by "fail[ing] to take any meaningful steps to protect the Plans' [p]articipants" from investments in RadioShack stock. *Singh v. RadioShack Corp.*, No. 4:14-cv-959 (N.D.Tex). Notably, the plaintiff does *not* allege that the value of the RadioShack stock held by the Plans was artificially inflated due to the withholding of material information; rather, the plaintiff alleges that the Plans' fiduciaries had a duty to protect the Plans from an *inevitable* decline in the RadioShack share price. Indeed, the complaint points to numerous financial reports and articles that highlighted RadioShack's poor financial position. It was not that the Plans' fiduciaries knew or should have known that the stock was trading above its fair market value because of the lack of proper disclosure, but rather that the fiduciaries apparently did not act when "RadioShack's descent into irrelevance and certain oblivion was gradual but sure." As the complaint states:

> The thrust of Plaintiff's allegations is that Defendants allowed the imprudent investment of the Plans' assets in RadioShack equity throughout the Class Period despite the fact that they knew or should have known that such investment was imprudent as a retirement vehicle because of the sea-change in the central risk/profile and business prospects of the Company caused in part by corporate mismanagement and, inter alia: (a) the massive consumer shift away from brick-and-mortar stores like RadioShack towards online retailers; (b) the drastic deterioration in consumer demand for RadioShack's outdated products and services; and (c) the severely deteriorating financial condition of the Company, including the collapse of the Company Stock price, and the Company's increasing risk of bankruptcy. As a consequence of the foregoing, significant investment of employees' retirement savings in Company Stock would inevitably result in substantial losses to the Plans and, consequently, to the Plans' Participants.

Therefore, the Plans' fiduciaries are being challenged for the poor performance of RadioShack stock irrespective of the accuracy of the RadioShack stock price at any given point in time.

What these Lawsuits Mean for Plan Sponsors and Fiduciaries

The *Kodak* and *RadioShack* cases demonstrate that the plaintiffs' bar is willing to test the post-*Dudenhoeffer* waters, looking for opportunities to bring claims based on poor performance, while avoiding claims based on over-valuation. Plan sponsors and fiduciaries of plans being maintained by struggling companies are considering hiring an independent fiduciary to monitor the company stock fund in the company's plan. Others are considering either freezing the company stock fund or terminating the fund altogether. In any event, we think more cases based on allegations of poor performance will be forthcoming.

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