

Groom Law Group is representing defendants in several stock drop lawsuits and we continue to track developments in this area. If you would like further information or have question, please contact:

Andrew C. Banducci
abanducci@groom.com
(202) 861-5439

Thomas S. Gigot
tgigot@groom.com
(202) 861-6624

Lars C. Golombic
lgolombic@groom.com
(202) 861-6615

Mike J. Prame
mprame@groom.com
(202) 861-6633

Julia Zuckerman
jzuckerman@groom.com
(202) 861-6605

Sarah A. Zumwalt
szumwalt@groom.com
(202) 861-5432

Seventh Circuit - Release Bars Participant's Stock Drop Claims; § 404(c) Safe Harbor is a Defense to Disclosure and Fiduciary Monitoring Claims, But Not to Claims Based on Fiduciaries' Selection of Plan Investment Options

The Seventh Circuit has issued in the last few years a series of noteworthy ERISA decisions. Its decision in *Howell v Motorola, Inc.* -- F.3d --, 2011 WL 183966 (Jan. 21, 2011) is another important decision with potentially broad implications.

As discussed in greater detail below, the Seventh Circuit ruled in *Howell* that a release executed by one plaintiff barred his ERISA-based stock drop claims, even though claims for benefits under the Motorola plan were expressly carved out from the release. The Court also held that ERISA § 404(c) precluded plaintiffs from proceeding with claims that (a) the plan fiduciaries did not disclose sufficient information to participants regarding Motorola's financial condition; and (b) those who appointed the plan fiduciaries did not sufficiently monitor their appointees. But the Court adopted the position long taken by the DOL that § 404(c) does not apply to claims based on the plan fiduciaries' selection of imprudent investment options. The Court nevertheless granted summary judgment to defendants on the prudence claim, concluding that there was no evidence that Motorola faced an imminent financial collapse.

Background

In 1999, Motorola Credit Corporation agreed to finance a Turkish wireless infrastructure project. Over the span of two years, Motorola Credit lent \$1.8 billion in connection with the project. The borrower defaulted in May 2001.

The Motorola 401(k) Savings Plan, a defined contribution plan, included Motorola stock as an investment option. In 1999, Motorola stock was trading at \$30 per share. The share price increased to \$40 as of May 2000, but fell to approximately \$15 with the disclosure of the credit default.

In their stock drop lawsuit, the plaintiff plan participants asserted ERISA breach of fiduciary duty claims based on the plan fiduciaries': (1) continued offering of Motorola stock as a plan investment option; (2) alleged failure to disclose to participants information about the financing arrangement; and (3) alleged failure to appoint competent members to serve on the plan's fiduciary committee and to monitor their activities adequately.

The Seventh Circuit's Decision

The Court initially reviewed the question of whether a release executed by one of the plaintiffs barred his claims under ERISA. The release expressly referenced claims under ERISA, but carved out from the scope of the release "any claims for benefits under the Motorola employee benefits plan." The Court held that the carve-out applied only to the participant's vested account balance as of the day that he signed the release. Accordingly, the Court concluded that the release barred the participant's claims – individual and on behalf of the Plan – based on a theory that his account would have been worth more had the fiduciaries not breached their duties. In reaching this conclusion, the Court also ruled that the release did not violate ERISA's anti-alienation rules, 29 U.S.C. § 1110(a).

Because not all plaintiffs had signed a release, the Court went onto to consider defendants' 404(c) defense. In an amicus brief filed with the Court, DOL argued that the § 404(c) safe harbor does not apply to breach of fiduciary duty claims based on the fiduciary's initial selection of the plan investment options and decisions to continue to make those options available to plan participants. The Court agreed, opining that § 404(c) "creates a safe harbor only with respect to decision that the participant can make" and that the "choice of which investments will be presented in the menu that the plan sponsor adopts is not within the participant's power."

With respect to plaintiffs' claim that defendants failed to disclose material information about the problems with the Turkish financing arrangement, the Court held that § 404(c) applied and that defendants had satisfied their disclosure obligations by providing, among other things, a general description of the objectives and risk of the Motorola stock fund. In other words, the Court considered the fiduciaries' disclosure obligations to be coextensive with the requirements of the § 404(c) safe harbor.

The Court acknowledged that a fiduciary could breach his ERISA duties by intentionally misrepresenting or deliberately concealing material information from plan participants, but that the plaintiffs had not offered sufficient evidence that had occurred. In reaching this conclusion, the Court confirmed that ERISA plan fiduciaries are not required to provide information regarding the company's financial condition to plan participants "in real time."

The Court applied a similar analysis to the claim that defendants failed to adequately monitor the members of plan's administrative committee. Plaintiffs argued the members of the Board of Directors were required to review the business decisions of the plan fiduciaries. However, the Court held that the defendants qualified for the § 404(c) safe harbor with respect to the monitoring claim. Moreover, the Court concluded the defendants were entitled to summary judgment on the merits because the Plan procedures required annual renewal of appointments to the administrative committee, periodic reports by the committee to the Board, and outside auditing of the Plan by KPMG.

Finally, with regard to the prudence claim that survived the §404(c) challenge, the Court found that the plan was adequately diversified with other investment options, that there was no evidence that Motorola was facing imminent collapse, and that Plaintiffs otherwise failed to establish that Defendants should have known that Motorola stock had become "so risky or worthless" as to justify its withdrawal as a plan investment option. Accordingly, the Court ruled that defendants were entitled to summary judgment on the prudence claim.

This publication is provided for educational and informational purposes only and does not contain legal advice. The information should in no way be taken as an indication of future legal results. Accordingly, you should not act on any information provided without consulting legal counsel. To comply with U.S. Treasury Regulations, we also inform you that, unless expressly stated otherwise, any tax advice contained in this communication is not intended to be used and cannot be used by any taxpayer to avoid penalties under the Internal Revenue Code, and such advice cannot be quoted or referenced to promote or market to another party any transaction or matter addressed in this communication.

Observations

At the end of 2009, the Third Circuit ruled in *In re Schering-Plough Corp. ERISA Litigation*, 589 F.3d 585 (3rd. Cir. 2009) that a release could preclude a plaintiff from serving as a class representative in a stock drop lawsuit. The Seventh Circuit's holding that a release of ERISA claims is an effective defense to individual and Plan-based liability theories provides greater certainty to employers who obtain such releases in connection with severance plans and other similar employment arrangements. It is expected the Seventh Circuit's decision relating to releases will be applied in the pending 401(k) fee cases and other ERISA class action lawsuits, many of which are brought by former employees.

The Seventh Circuit's conclusion that the ERISA § 404(c) safe harbor does not apply to the selection of the plan investment options deepens the split in the circuits on this issue. However, the lack of § 404(c) protection for prudence claims may not be so significant as the Seventh Circuit's decision underscores that plaintiffs bringing stock drop claims generally have to establish that the company was in danger of financial collapse.

This publication is provided for educational and informational purposes only and does not contain legal advice. The information should in no way be taken as an indication of future legal results. Accordingly, you should not act on any information provided without consulting legal counsel. To comply with U.S. Treasury Regulations, we also inform you that, unless expressly stated otherwise, any tax advice contained in this communication is not intended to be used and cannot be used by any taxpayer to avoid penalties under the Internal Revenue Code, and such advice cannot be quoted or referenced to promote or market to another party any transaction or matter addressed in this communication.