

The Courts Address Rights Relating to Employer Stock

July 23, 2007

In April 2007, both the U.S. District Court for the District of Hawaii and the U.S. District Court for the District of New Jersey addressed issues relating to employer stock held in retirement plans other than employee stock ownership plans (ESOPs). Although neither case addressed ESOP issues specifically, the decisions in both cases affect *all* plans holding employer stock.

***Goodin v. Innovative Technical Solutions, Inc.*, 2007 U.S. Dist. LEXIS 31320 (D.C. Haw. 2007).**

On April 27, 2007, the U.S. District Court for the District of Hawaii, on a motion for summary judgment, ruled that an employer violated the anticutback rules by eliminating 401(k) participants' rights to receive a put option with respect to in-kind distributions of privately held stock. Innovative Technical Solutions, Inc. (ITS), a privately held company, established a retirement plan in 1998 that contained both a 401(k) component and an ESOP component (the Plan). ITS was primarily capitalized through employee purchases of ITS stock through salary deferrals under the 401(k) component of the Plan. In fact, all of the ITS stock held by the Plan was held in the 401(k) portion of the Plan, and the ESOP portion was never funded. The Plan provided that distributions of ITS stock would be made in either cash or stock. If the distributions were made in stock, the Plan provided a put option with respect to such stock through which the participant could require ITS to repurchase the stock at fair market value. The put option provision was not required by applicable law.

In 2004, ITS terminated the Plan and adopted a new plan (the New Plan) that also included both a 401(k) and an ESOP component. The assets from the Plan were transferred to the New Plan. The New Plan eliminated the put option right with respect to stock distributions from the 401(k) portion but continued to permit put options for distributions from the ESOP component. ERISA's anticutback rules do not prevent employers from specifying in advance of a benefit accrual that the availability of the protected benefit will be limited; however, the rules do prohibit employers from eliminating participants' optional forms of benefits that have accrued. The put option right was given to the participants at the inception of the Plan and was not limited. Accordingly, the court found that the put option right was an optional form of benefit because it is a factor that affects the value of the benefit form, and that eliminating the put option denied the participants a cash market for their stock distribution. It seems clear, however, that the put option could have been eliminated as to postamendment plan contributions; it is the ostensibly retroactive effect of the amendment that is in violation of the anticutback rules.

***Ward v. Avaya, Inc.*, 2007 U.S. Dist. LEXIS 27568 (D.C.N.J 2007).**

On April 12, 2007, the U.S. District Court for the District of New Jersey, on a motion to dismiss, reviewed a plan fiduciary's decision to (i) continue to offer employer stock as an investment option under the plan and (ii) continue to allow plan assets to remain invested in employer stock in the face of falling stock prices. Based on the fact that the plans in question were required, by the express terms of the plan document, to offer the employer common stock as an investment option, the court reviewed the complaint using an abuse of discretion standard of review and held that a decline in stock value, without more, is not sufficient to prove an abuse of discretion.

Avaya, Inc. (Avaya) was spun off from Lucent Technologies, Inc. in 2000. After the spin-off, Avaya sponsored three eligible individual account plans (EIAPs), each of which was required to offer Avaya common stock as an investment option. In the two years following the spin-off, the price of Avaya common stock fell from \$22.88 to \$1.15 per share. Based on the extreme drop in the per-share price of Avaya common stock, the plaintiffs alleged, in part, that the plan fiduciaries failed to monitor adequately the plans' investment options and permitted the assets of all three plans to remain invested in Avaya stock after it was imprudent to do so.

The court declined to review the complaint based on the fact that each of the plans was an EIAP, and thus generally exempt from the diversification requirement under section 404(a)(2) of ERISA. Instead, based on the fact that "each of the Plans at issue *required* that the Avaya Stock Fund be included as an investment option," the court applied the deferential standard afforded a fiduciary of an ESOP as established in *Moench v. Robertson*, 62 F.3d 553 (3d Cir. 1995). Under this standard, an ESOP fiduciary who invests plan assets in employer stock is entitled to a presumption that it acted consistently with ERISA by virtue of that decision. This has become known as the "Moench Presumption," which may be overcome if the plaintiff can establish that the fiduciary abused its discretion by investing in employer stock, shifting the burden of proof to the plaintiff to show that the fiduciary's decision was an abuse of discretion. In applying this deferential standard, the court in *Avaya* found that "[a] decline in the price of a company's stock, even a significant decline, is not sufficient to constitute a breach of fiduciary duty absent allegations of other circumstances such as fraudulent conduct or knowledge of the company's impending collapse." Since neither claim was alleged by plaintiffs, the court granted the defendants' motion to dismiss on this point. Thus, the court extended the protection of the deferential standard to those qualified retirement plans that do not qualify as ESOPs but do mandate the inclusion of an employer stock fund as an investment option.

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