

The First Case of Its Kind: Morgan Lewis Team Wins Post-Enron ERISA “Stock Drop” Trial for US Airways

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In the first post-Enron “stock drop” case to go to judgment following a trial, *DiFelice v. US Airways, Inc.*, Case No. 1:04cv889 (E.D. Va. June 26, 2006), a Morgan Lewis team headed by Labor and Employment Law partners **Charles C. Jackson** and **Christopher A. Weals** prevailed at trial in an ERISA class action brought against US Airways, Inc. (<http://www.usairways.com>). The court held that US Airways did not breach its fiduciary duties under ERISA by continuing to permit voluntary investment in the stock of its parent corporation, US Airways Group, Inc., in the company’s 401(k) plan during the months leading up to US Airways’ bankruptcy in 2002.

In addition to the company stock fund, the US Airways 401(k) plan offered 12 different investment options with varying levels of risk and return. The court found that the plan’s investment options were sufficiently diverse enough that participants could select a portfolio mix that achieved their individually desired level of risk and return. During the period covered by the lawsuit, approximately 5% of the plan’s assets were invested in the company stock fund.

Under the plan, US Airways was the fiduciary with discretionary authority to select or remove investment options. US Airways delegated its authority to a pension investment committee made up of three senior executives. Neither the plan nor the trust agreement mandated the offering of the company stock fund as an investment alternative, and US Airways had discretion to terminate the company stock fund at any time. The pension investment committee met on a regular basis to review the performance of investment options provided in the plan and to consult with financial advisors. Based on its continuing review of information about the company and its prospects, the committee determined that it was prudent to continue offering the company stock fund as an investment option in the plan. Additionally, the committee provided participants with publications concerning investment diversification. The court found that the plan and the company stock fund did not suffer from the problems alleged in the *Enron* lawsuit, as the plan did not compel participants to invest in the stock fund and, in contrast with the *Enron* case, there was no allegation of fraud or deception on the part of US Airways.

Prior to its bankruptcy filing in August 2002, US Airways experienced substantial financial difficulties. These difficulties were exacerbated by the terrorist attacks of September 11, 2001. Much of the trial centered on the reasonableness of US Airways’ business plan for surviving 9/11 and for putting the airline on the road to profitability. This included bringing in new senior management, achieving major cost reductions, and securing loan guarantees from the Air Transportation Safety Board.

After a six-day bench trial, the court soundly rejected the claims of the plaintiff class. The court held that employer stock, while an admittedly risky investment, is a favored investment under ERISA and is

an appropriate choice to offer as part of a diversified retirement portfolio. Citing modern portfolio theory and the Department of Labor's (DOL's) regulations on prudent investing, the court found that "ERISA requires that the prudence of selecting a particular investment be viewed in light of its contribution to the risk and return of the entire portfolio, and not in light of its individual risk." The court also found the continued offering of US Airways stock for investment to be prudent based on evidence of US Airways' business plan to improve its prospects, despite the failure of the plan and the company's subsequent filing for bankruptcy. In so ruling, the court rejected expert testimony from plaintiffs that US Airways should have used a bankruptcy predictability model to predict its own bankruptcy, and testimony that investment in US Airways stock was "imprudent."

This case is a very significant ERISA development. First, it is the first decision on the merits after a full trial in the post-*Enron* era. While courts have wrestled with "stock drop" issues in the context of motions to dismiss, no court had yet addressed these matters on a fully developed record, where plaintiffs no longer enjoy the benefit of the doubt as they do on a motion to dismiss.

Second, the case involved a plan sponsor that eventually filed for Chapter 11 bankruptcy protection, resulting in a complete loss of value in the common stock. The court focused not on the ultimate outcome but on the viability of the company's restructuring plan and the soundness of the process the fiduciaries used to monitor the company stock fund. This reinforces the need for fiduciary committees to engage in "procedural prudence," including regular, systematic monitoring of employer stock, along with all other 401(k) investment options, abiding by Section 404(c) of ERISA, allowing participants to diversify out of employer stock funds and/or using an independent fiduciary where appropriate.

Finally, the court's explicit endorsement of modern portfolio theory brings a much-needed framework to the problem of how to evaluate the prudence of employer stock within a defined contribution plan. The plaintiffs in *US Airways* urged the court to consider employer stock in isolation and to evaluate its prudence as a stand-alone investment. The court found that approach to be inconsistent with both modern portfolio management theory and the DOL's regulations under Section 404(a) of ERISA. In short, employer stock must be viewed not in isolation but as part of an overall diversified retirement portfolio.

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