

Morgan Lewis Team Wins Second Post-Enron ERISA “Stock Drop” Trial for Tellabs

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In only the second post-*Enron* ERISA “stock drop” case to go to trial—and the second to be tried by Morgan Lewis—a trial team led by Labor and Employment partners Chuck Jackson, Debbie Davidson, and Sari Alamuddin secured a complete victory for Tellabs and its 401(k) plan fiduciaries (*Brieger, et al. v. Tellabs*, No. 06-1882 (N.D. Ill., June 1, 2009)).

The *Brieger* plaintiffs, on behalf of a nationwide class of plan participants, alleged that Tellabs stock was an “imprudent” 401(k) plan investment option under ERISA because (1) Tellabs executives (who were also plan fiduciaries) made misstatements to the market and to participants regarding sales/demand for Tellabs’ products, which operated to artificially inflate the stock price; and (2) the stock lost about 90% of its value between December 2000 and July 2003, when Tellabs and other telecom companies went through a significant industry downturn and Tellabs had reduced sales and multiple rounds of layoffs.

The court ruled that the Tellabs fiduciaries did not breach their ERISA fiduciary duties by continuing to offer the Tellabs Stock Fund (the Fund) as an investment option in the company’s 401(k) plan (the Plan) during the class period.

In its written posttrial findings of fact and conclusions of law, the *Brieger* court first ruled that the plan fiduciaries were “procedurally prudent” under ERISA with respect to the Fund. The court found that executive-level fiduciaries “credibly testified that they did not need to engage in an independent analysis of Tellabs’ prospects based on their extensive knowledge of Tellabs by virtue of their roles as high level executives and employees.”

The court also ruled that, regardless of procedural prudence, “defendants would still be entitled to judgment on the prudence claim because the evidence shows that a reasonably prudent individual in similar circumstances who undertook such an examination would not have sold Tellabs stock held by the Plan or removed the Fund as an investment option.”

Initially, the court noted that the plan document required the availability of the Fund as an investment option. Accordingly, the fiduciaries would only be obligated to close or divest the Fund if its continued availability would violate ERISA’s general prudence requirements.

The court rejected plaintiffs’ argument that the prolonged, substantial decline in Tellabs’ stock price (from \$63 to \$6 per share), Tellabs’ slowing product sales, numerous layoffs, and general problems in the

telecommunications industry rendered Tellabs an imprudent plan investment. Moreover, the court found that Tellabs' numerous cost-cutting measures—including multiple rounds of layoffs—were “prophylactic measures to protect the company” and that they did not suggest that the company was at risk of bankruptcy, particularly in light of Tellabs' “strong cash position, positive cash flow, and low amounts of debt.” The court also pointed out that, while Tellabs' product sales had slowed, the fiduciaries continued to receive information suggesting that the company would hit revised forecast numbers and that the industry would rebound.

The court next rejected plaintiffs' misrepresentation/omission claim because plaintiffs failed to prove that defendants made material misrepresentations or failed to disclose material information. Rather, the court found that all of Tellabs' statements to the market were “accurate based on the information that was available to defendants, including their internal forecasting, discussions with Tellabs sales teams, information received from customers, and analysis provided by industry experts.” The court further noted the extensiveness of Tellabs' internal disclosures to employees regarding the company's business condition.

Finally, the court concluded that, even if plaintiffs had established their claims, they would be time-barred by ERISA's three-year statute of limitations because plaintiffs had “actual knowledge” of the facts giving rise to their claims more than three years before they filed suit. The court had previously denied summary judgment to defendants on this issue, finding triable issues of fact as to whether ERISA's six-year “fraud or concealment” limitations period should apply because plaintiffs claimed defendants misrepresented and withheld key information from plan participants. At trial, however, the court ruled that “plaintiffs failed to prove that defendants made any fraudulent misrepresentations or concealed from plaintiffs material facts about the company.” Thus, the court concluded that ERISA's three-year limitations period began to run no later than June 19, 2001, by which point plaintiffs “had observed Tellabs stock price drop . . . sixty-six percent . . .[,] defendants made numerous statements . . . about the serious problems facing both Tellabs and the telecommunications industry . . . [, and] [a]ll the while, plaintiffs knew that Tellabs stock remained one of the available investment options in the Plan.” Accordingly, because the complaint was filed more than a year after June 19, 2004, plaintiffs' claims were time-barred.

As discussed in a prior Morgan Lewis Labor and Employment LawFlash (available at http://www.morganlewis.com/pubs/LEPG_PostEnron_LF_18jul06.pdf), the first post-*Enron* ERISA “stock drop” case to proceed to trial was *DiFelice v. U.S. Airways, Inc.*, 436 F. Supp. 2d 756 (E.D. Va. 2006), *aff'd*, 497 F.3d 410 (4th Cir. 2007), which was also tried and won by a Morgan Lewis team. Together, *DiFelice* and *Brieger* demonstrate that there is a significant difference between pleading a stock-drop complaint that survives a Rule 12 motion to dismiss and actually proving that claim on the merits. While stock-drop claims are framed with the benefit of hindsight, both courts evaluated the fiduciaries' conduct under the circumstances then prevailing, which is what ERISA requires.

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