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ROUND 2: FIDUCIARIES AGAIN DEFEAT ERISA STOCK CLAIMS AT TRIAL IN *BRIEGER ET AL. V. TELLABS, INC.*

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Three years ago, we reported on the first post-*Enron* "stock drop" case to go to trial, *DiFelice v. US Airways, Inc.*, an important victory for fiduciaries and insurers that demonstrated the weaknesses of the ERISA "stock drop" claims when subjected to the crucible of trial. *See* "The Pro-Fiduciary Trial Ruling in *DiFelice v. US Airways*, and What It Means for ERISA Stock Litigation," *PLUS Journal*, vol. XIX, no. 9 (Sept. 2006). Yet filings of ERISA stock cases have not diminished since *US Airways*. Fiduciaries and their insurers continue to respond largely by motion practice and settling if the motions are not successful. Very recently, plaintiffs have been able to achieve substantial settlements with Merrill Lynch ($75 million), Tyco ($70.5 million) and Countrywide Financial ($55 million). These settlements are powerful incentives to the plaintiffs' bar. Though settlements can be driven by unique complexities, with the fiduciaries' recent trial success in *Breiger v. Tellabs, Inc.*, 2009 WL 1835930 (N.D. Ill. 2009), there is reason anew to take tougher positions in ERISA stock cases. In *Tellabs*, the corporate and fiduciary defendants secured another complete victory, proving, once again, that stock drop cases are eminently winnable if the defendants, and their carriers, are willing to stay the course and allow the trier of fact to hear the evidence.[1]

Before delving into the *Tellabs* case and its implications, let's take a moment to review how the law in this area has developed since the *US Airways* decision in 2006.

FROM CORPORATE SCANDALS TO 'ARTIFICIAL INFLATION'

The first wave of stock drop suits involved sensational corporate scandals that grabbed headlines and gave plaintiffs a good story to tell. The early defendants—fiduciaries of the Enron, WorldCom, Global Crossing, Kmart, and other defined contribution (DC) plans—faced an uphill battle in the face of allegations that, as corporate insiders who also served as fiduciaries, they knew about corporate wrong-doing but failed to take action to protect employees who owned stock in the company through the retirement plan.

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With the passage of Sarbanes-Oxley and the stock market recovery beginning in 2003, the corporate scandals and bankruptcies seemed to diminish. However, enterprising plaintiffs' class action firms, many with backgrounds in securities litigation, saw an opportunity and exploited it by bringing tandem ERISA breach of fiduciary suits against companies that were being sued for securities fraud and also held company stock in their DC plans. The complaints in this new wave of stock drop litigation looked remarkably like 10b-5 complaints, with the added layer of allegations that the fiduciaries acted "imprudently" by allowing plan participants to invest in company stock when the defendants "knew or should have known" that the stock price was "artificially inflated" due to material misrepresentations to the market. This spike in litigation was also fueled by ERISA's (comparatively) easier burden of proof: whereas the securities plaintiff must demonstrate scienter under the PSLRA, the ERISA "stock drop" plaintiff does not need material misrepresentations to win but need only prove that the continued offering of company stock to participants is not "prudent."

THE DEFENSE FINDS SOME QUICK EXITS THROUGH MOTION PRACTICE

The defense bar has had some success in cutting off ERISA stock cases comparatively early in the process through motion practice. Two of the most promising defenses to such claims address, respectively, the sufficiency of allegations made in the plaintiffs' complaint and the "safe harbor" defense of ERISA Section 404(c).

Moench v. Robertson, decided in 1995 by the Third Circuit Court of Appeals, has proven to be one of the more effective

defense weapons in the stock drop wars. *Moench* not only established the principle that company stock is a different kind of investment that enjoys unique status under ERISA, it took ERISA's requirement that pension plans be administered in accordance with their terms to its logical conclusion: if the plan requires company stock as an investment option (so-called "hardwiring"), the fiduciaries must respect the settlor's decision and can override the plan's terms only in extraordinary circumstances. The *Moench* "presumption of prudence" now guides the analysis in many stock drop cases, and courts have become increasingly willing to use the plaintiff's inability to overcome the presumption as grounds for dismissing the complaint or ruling for defendants on summary judgment. We expect the Supreme Court's recent decisions toughening Rule 12(b)(6) motion to dismiss standards to play an increasing role in testing the plaintiffs' complaint under *Moench*. *See Bell Atlantic Corp. v. Twombly,* 550 U.S. 544 (2007); *Ashcroft v. Iqbal,* 129 S. Ct. 1937 (2009).

The second defense to emerge is ERISA's safe-harbor provision, Section 404(c), which relieves fiduciaries of liability for losses in participant-directed plans that result from a participant's control over investment decisions. Though the Department of Labor and one appellate court (in *dicta*) disagree, three appellate courts (most recently the Seventh Circuit in *Hecker v. Deere*) have interpreted Section 404(c) to bar claims of breach of fiduciary duty with respect to investment options in a DC plan and one district court (based on *Deere*) has applied Section 404(c) to bar participant claims in an ERISA stock drop case.

BRIEGER et. al v. TELLABS, INC.

Following the filing of a securities class action against Tellabs in 2002 regarding stock declines in 2001, *Makor Issues & Rights, Ltd. v. Tellabs, Inc.* (a case that went to the Supreme Court to address securities pleadings requirements under the PSLRA and is now back in the district court), the ERISA plaintiffs in *Brieger v. Tellabs* also sued in the Chicago federal court in 2006 concerning the same events at issue in *Makor Rights*. The *Brieger* plaintiffs brought a class action on behalf of all plan participants in Tellabs' 401(k) plan. They alleged that the Tellabs fiduciaries (including top management) breached their duties by permitting plan participants to invest in Tellabs stock while its price was declining and by making alleged misrepresentations concerning Tellabs' business prospects. Prior to trial, a class was certified and the court denied Tellabs' motion for summary judgment based on the statute of limitations (because plaintiffs asserted they would establish fraud or concealment at trial to toll the statute).

Rather than settle, Tellabs (with the backing of its insurer) chose to go to trial. At trial, many of Tellabs' top executives and board members were called by plaintiffs as witnesses and gave detailed accounts of Tellabs' business in the midst of the telecom industry downturn during 2001-2003.

In its post-trial findings of fact and conclusions of law, the district court made numerous findings that doomed the plaintiffs' case. The court determined that the Tellabs witnesses testified accurately and credibly concerning Tellabs' evolving (and declining) business prospects, rejecting plaintiffs' misrepresentations claims. The court also ruled that the plan fiduciaries acted in a "procedurally prudent" manner in administering the Tellabs 401(k) plan, and rejected contrary, rote testimony of the plaintiffs' procedural prudence expert because it "elevated form over substance."

The court also determined, without regard to the *Moench* presumption, that "a reasonably prudent individual in similar circumstances who undertook such an examination would not have sold the Plan's Tellabs stock or removed it as an investment option" as the plaintiffs argued. The court rejected plaintiffs' argument that the prolonged decline in Tellabs' stock price (from $63 to $6 per share), Tellabs' slowing product sales, numerous layoffs, and telecommunications industry issues rendered Tellabs stock an imprudent investment. The court determined that Tellabs' numerous cost-cutting measures —including 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 amount 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 rejected the testimony of the plaintiffs' substantive prudence expert as an isolated, one-day snapshot that did not consider that retirement plans are long-term investments—essentially an improper "I know it when I see it" test.

Finally, the court concluded that plaintiffs' claims were time-barred by ERISA's three-year statute of limitations because plaintiffs had "actual knowledge" of the facts more than three years before they filed suit. Plaintiffs failed to come through with evidence of fraud or concealment (which would have extended the limitations period to six years), and the three-year limitations period ran on June 19, 2004, twenty-two months before the case was filed.

Like *US Airways*, the *Tellabs* post-trial decision demonstrates that there is a big difference between settling post-motion ERISA class actions based on foggy notions of their merits vs. taking them to trial and demonstrating through evidence and testimony that many of these cases simply seek to exploit adverse business developments under the guise of enforcing ERISA's fiduciary provisions. Credible testifying defendants with good reasons for their business and fiduciary decisions are a powerful antidote to the one-sided characterizations and allegations of plaintiffs woven together with hindsight. Where a business decision ends and a fiduciary one begins obviously changes from case to case, but an evidentiary focus through testimony on recreating the factors contributing to a given business decision comport well with the analogous inquiry courts make of the fiduciaries' conduct and whether it was appropriate under the circumstances then prevailing. This is tricky territory for the plaintiffs' bar which has not yet learned the transition from allegations that beat dismissal on motions to proofs that establish an ERISA violation.

TAKEAWAYS FOR LITIGATION MANAGEMENT AND SETTLEMENT OF CLAIMS

Despite these pro-defense legal developments, ERISA cases not resolved by motion are still largely settled based on estimates by plaintiffs' and defendants'

counsel regarding the merits and defenses, the pressure, cost and burden of discovery, especially electronic discovery, and, frankly, the amount of available insurance. (For a summary of ERISA class settlements, see **www.erisasettlements.com**, a website sponsored by Fiduciary Counselors, Inc.) These settlements—whether high or modest—provide incentives for the continued filing of ERISA stock drop cases. The knowledge that a settlement payout is likely if the case survives motion practice drives many ERISA stock drop lawsuits. In addition, many plaintiffs' counsel use ERISA stock cases as a surrogate for securities cases for which there is insufficient evidence of scienter. While the courts may eventually develop strong statements that ERISA does not exist for this purpose, in our view the best avenue for defeating stock claims is to take them to trial. The recent experience of Tellabs underscores our point.

The plaintiffs' bar has followed the same strategy and formula in ERISA stock drop suits that it has used for many years in securities class action litigation. By filing a large number of suits, plaintiffs know that a significant number will survive motions to dismiss. They then count on the very high cost of complex litigation, the defendants' desire to avoid the distraction of intrusive discovery and lengthy litigation, and a perceived unwillingness on the part of defendants to take cases to trial to extract large settlements. Again, the recent stock drop settlements in 2009 such as Merrill Lynch ($75 million), Tyco ($70.5 million) and Countrywide Financial ($55 million) demonstrate both that plaintiffs have the resources to absorb some early dismissals and that the defense bar must do more.

In our view, these large settlements are far too easily achieved by the plaintiffs. It shouldn't be the case that merely filing a complaint that survives a motion to dismiss entitles plaintiffs to a large settlement and a huge fee. The problem is that once a plaintiff survives the motion to dismiss, it is much too seldom that class certification, summary judgment or some other pre-trial event will result in dismissal of the case or put the plaintiff sufficiently at risk that a modest settlement can be negotiated. Therefore, when coupled with the high cost and distraction of discovery, there are incentives for defendants to negotiate settlements that depend too little on the merits and the actual evidence, and too much on future litigation costs, the amount of available insurance and other non-merits factors.

The premise of this article is that the best way to change that dynamic is for defendants to have a credible threat of trial in all but the most egregious cases. The *US Airways* and *Tellabs* trials have demonstrated that plaintiffs do much better with allegations than they do with proof. While plaintiffs do a lot of posturing at mediations about needing and wanting to try more cases, their results at trial have not equaled their bluster at mediations. Plaintiffs will be gun-shy about demanding high settlements based on marginal facts if they believe they will be forced to try the case. If fiduciaries and their insurers show the resolve that is needed, then plaintiffs' unwillingness to invest in cases they very likely will lose will start to have a material impact on settlement negotiations. In the past, plaintiffs have bluffed better than defendants in many cases, and have been willing to creep closer to trial, while counting on defendants to fold. If defendants show a true willingness to take cases to trial, the impact on settlements will follow.

We are not suggesting that there is a "one size fits all" strategy for the defense of ERISA stock drop cases. Each case has its own unique combination of factors, which will be evaluated by experienced defense counsel and insurers or their counsel. The strategy will be customized to fit the case and will evolve as the case develops. However, the general dynamic that needs to be altered is the one that has existed for years—namely that defendants either win or lose the motion to dismiss and, if they lose, then they inevitably settle the case. They might settle it soon after the motion to dismiss ruling or after years of discovery, but either way, settlement is inevitable. When settlement is inevitable, defendants do not achieve merits-based settlements. In other types of litigation, where cases are frequently tried, there is a much closer correlation between the merits and the settlement amounts.

One of the primary reasons that stock drop cases are rarely tried is that defense counsel may not have the ability, experience, willingness or nerve to try the case. If plaintiffs perceive that counsel does not have the ability and willingness to try a case, this will have a major, adverse impact on settlement negotiations as a case progresses towards trial. The company's regular corporate counsel or even securities litigation counsel that it has used in the past may not have the right experience to handle an ERISA stock drop case, especially through trial, making the selection of defense counsel very important in these cases.

We believe that if fiduciaries and insurers have the resolve to take additional stock drop cases to trial, and if they negotiate without having an attitude that the case must settle, the size of settlements will decline. Plaintiffs will not want to invest the additional resources that are required to try cases and, based on past results, they will fear the outcomes at trial. With willing defendants and willing insurers, coupled with the right defense counsel, the strong trend established by the trials in *US Airways* and *Tellabs* will be continued. With additional defense victories at trial, we can change the "easy money" dynamic that plaintiffs have had for too long.

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