

Employees May Sue Under ERISA When Company's Stock Crashes

Third Circuit resolves standing issue that has divided federal courts

By Lisa Brennan

Participants in 401(k) plans face a smorgasbord of options, some riskier than others. Now, those who invested in company stock only to see it plummet have been handed a procedural remedy.

A federal appeals court has ruled that participants can sue when their company's alleged fiduciary violations harm only those who chose the stock option.

The Aug. 19 ruling by the Third U.S. Circuit Court of Appeals opens the door for a potential class of 11,000 current and former Schering-Plough workers to sue the Kenilworth drug maker, former CEO Robert Kogan, other fiduciaries and the Vanguard Group, the 401(k) plan's trustee, over losses estimated at \$138 million.

The appeals court, deciding an issue that has divided federal courts across the country, found that section 409(a) of the Employee Retirement Income Security Act, which provides for recovery of any losses to the plan caused by a fiduciary breach, gives the plaintiffs standing, and that section 502(a)(2), which permits a civil action for relief under 409(a), allows them to recover damages.

Three days after the ruling in *In re: Schering-Plough Corp. ERISA Litigation*, 04-3073, plaintiffs in another 401(k) ERISA case had reason to rejoice. U.S. District Judge John Bissell in Newark approved a \$90 million settlement for current and former

employees of Royal Dutch Shell, who had alleged that Shell violated its fiduciary duty by misstating oil reserve totals, causing its stock to nosedive. The settlement, in *In re Royal Dutch/Shell Transport ERISA Litigation*, CV-04-1398, allows them to recoup 78 percent of their losses.

"Plaintiffs ... in our district have had two huge rulings this week," says Joseph DePalma of Newark's Lite DePalma Greenberg & Rivas, who represents plaintiffs in both cases.

The unanimous Third Circuit ruling in *Schering-Plough* reverses last year's lower court decision to dismiss the case for failure to state a claim. The panel found that U.S. District Judge Katharine Hayden misread the company's 401(k) plan in two key ways. She found that the plaintiffs' contributions were not assets of the savings plan and not aggregated, and that the plaintiffs sought damages only for their individualized losses, which she concluded were unique for each person.

Her errors "directly conflict with the express terms of the savings plan as well as other allegations of the complaint," wrote Senior U.S. District Judge Arthur Alarcon, sitting by designation from the Ninth Circuit, who was joined by Judges Walter Stapleton and Thomas Ambro.

The first order of business for Hayden, Alarcon wrote, is to get an answer out of the defendants, who did not respond to the initial complaint because Hayden dismissed the case for

lack of standing before the answer-filing deadline. Hayden also must address the merits of the claims of fiduciary breaches.

The ruling, the first by a federal appeals court on the standing issue, is welcome news to plaintiffs' lawyers around the country bringing similar suits. Nearly 40 district courts have been split on whether 401(k) participants who elect to invest in company stock are protected by the ERISA sections.

"The ruling is a major, major statement that immediately lays to rest any doubts about the fact that participants in 401(k) company-stock cases are entitled to sue when things go wrong and something imprudent went on," says Ron Kilgard of Phoenix's Keller Rohrback, who is lead plaintiffs' counsel in similar cases against WorldCom, Global Crossing and Enron.

"The precedential value of this decision will extend way beyond the Third Circuit, especially because now standing isn't discretionary," says Joseph Meltzer, of Radnor, Pa.'s Schiffrin & Barroway, who represents the Schering plaintiffs with Peter LeVan Jr., of Philadelphia's Hanglely Aronchick Segal & Pudlin.

The lead plaintiffs — former Schering employees Jingdong Zhu, a scientist now working in the Midwest, and Adrian Field, now retired and living in central New Jersey — allege that they chose to invest in Schering stock, one of 14 options under the company's 401(k) plan, which permitted participants to invest up to 50 percent in stock with no company match.

At the end of 2001, the stock made up about 61 percent of the value of the saving plan's assets. More than 60 percent of employees in the plan had at least some assets allocated to company stock.

By then, a series of financial problems led to a fall in Schering stock that constituted 87 percent of the plan's drop in value and in 2002, 50 percent, amounting to a total of \$138 million.

The plaintiffs sued on Oct. 6, 2003, under section 502(a)(2) on behalf of participants in or beneficiaries of the saving plan between July 29, 1998, and that point, and whose accounts included investments in Schering stock.

They allege the defendants breached their fiduciary duties of prudence, care and loyalty by continuing to offer the company stock fund as an alternative when they knew the stock price was unlawfully and artificially inflated.

They also claim the defendants failed to disclose negative information about Schering and moreover that some defendants failed to take steps to avoid conflicts, such as by making appropriate disclosures, divesting the saving plan of Schering stock, consulting independent fiduciaries or resigning.

Lawyers for the U.S. Department

of Labor, arguing in support of the plaintiffs, highlighted the public policy issue at stake, noting that at the end of 2003, more than \$2 trillion of all private pension plan assets were held in individual account plans. "If the District Court and the defendants' broad arguments are correct, participants in 401(k) plans and other individual account plans, such as the Enron plans, would be unable to recover losses to the plan caused by fiduciary breaches, even if the majority of the plan's participants lost most of their retirement savings as a direct result of such breaches," Department of Labor attorney Theresa Gee wrote in her brief.

Gavin Rooney, who represents the defendants, along with Douglas Eakeley of Roseland's Lowenstein Sandler, deferred comment to Schering's executive director of global communications, Rosemarie Yancosek.

"We're disappointed with the decision," says Yancosek. "Right now we're exploring our options. We still think the case has no merit."

Rooney and Caroline Brown of Washington, D.C.'s Covington & Burling, say no decision has been made about an appeal. They could petition for re-argument en banc or petition the U.S. Supreme Court for certiorari. A petition for re-argument en banc is less likely to succeed since there was no dissent.

Among other things, the defendants claim that the plaintiffs do not represent the plan as a whole, that they improperly seek relief for each plan participant and that they fail to show detrimental reliance by plan participants on the defendant's alleged misrepresentations.

ERISA defense lawyer Matthew Renaud, of Chicago's Jenner & Block, says participants in 401(k) plans who suffer company stock losses have a more appropriate remedy under federal securities laws: they can join shareholders suing in 10(b) class actions.

Plaintiffs' lawyers say the recovery in 10(b) cases is insufficient to compensate 401(k) participants for significant losses of their life savings. ■