

Practical Insights

September 2006

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MANAGING FIDUCIARY RISK UNDER ERISA WHEN A COMPANY'S STOCK SUDDENLY DROPS IN PRICE

The Problem:

The financial collapse of companies where employees' retirement plan assets were heavily invested in their companies' stock has increased "stock drop" lawsuits under the Employee Retirement Income Security Act (ERISA)'s fiduciary duty rules. These lawsuits can also arise where a company's stock price has fallen due to an industry downturn or restatement of earnings. Individual account plans, such as 401(k) plans, stock bonus plans, profit sharing plans and employee stock ownership plans (ESOPs) that allow investment of plan assets in company stock are all susceptible to stock drop lawsuits.

How can a company manage the fiduciary risk of a stock drop lawsuit?

The Solution:

1. **Know Who is a Fiduciary and Who is Likely to be Sued.** Under ERISA, those who make (or have the responsibility to make) discretionary decisions concerning the distribution, administration or investment of plan assets are plan fiduciaries. These may include the employer, the plan and its administrator, plan trustees, corporate benefit committees and investment managers. Regularly review websites of plaintiff ERISA law firms, such as <http://www.erisafraud.com>, that list at-risk companies.

2. **Know the Rules Applicable to Fiduciaries.** ERISA requires fiduciaries to (1) know the plan's terms and to follow them, (2) diversify plan investments, unless prudence dictates (or ERISA requires) otherwise, (3) act prudently with a high degree of care, skill and diligence, and (4) act solely in the interest of plan participants and beneficiaries to provide them with the stated benefit when due and to pay reasonable plan costs. Fiduciaries must not engage in prohibited transactions, for example, those where the fiduciary or a party in interest, such as the employer, is the beneficiary of the transaction.

3. **Know the Type of Claims Being Made.** Lawsuits have been premised mainly on one or more of three theories, namely, (1) breach of ERISA's prudence rule, i.e., some event made it imprudent to invest or continue to invest in the employer's stock, (2) the fiduciary's failure to monitor those individuals or entities appointed to assist in the management of the plan, or (3) intentional or negligent misrepresentation or omission affecting the value of stock or participants' investment decisions.

4. **Educate Fiduciaries and Monitor Them and Plan Service Providers.** For plans with self-directed accounts, ensure full compliance with statutory and regulatory requirements governing plan terms, investment alternatives, investment transferability, and participant disclosure. For all individual account plans, ensure that plan fiduciaries know the plan's terms, their plan obligations and their fiduciary obligations. Evaluate and monitor plan service provider fees and charges to the plan.

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