UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF ILLINOIS

ANTHONY ABBOTT et al., Plaintiffs, v. **LOCKHEED MARTIN CORPORATION et al.,** Defendants.	Case No. 3:06-cv-701-MJR-DGW

DEFENDANTS' TRIAL BRIEF ON COMPANY STOCK CLAIM

When companies are sued for mismanagement of their 401(k) plan's company stock funds, it is virtually always because plan participants have lost substantial sums of their retirement savings due to exceptionally poor corporate performance. Even in the face of massive losses, fiduciary mismanagement is found in only the most egregious cases of fiduciary malfeasance—as when Enron plan participants lost 99% of their assets.

Plaintiffs' claim is, to say the least, unusual. During the applicable period, Lockheed Martin stock performed well, to the benefit of plan participants who invested in Lockheed Martin's company stock funds. Plan participants received exactly what they were told they would receive—and what they received was an appropriate investment that delivered strong returns and that was the product of responsible fiduciary decisionmaking.

During the course of this litigation, Plaintiffs have made three challenges to the company stock funds. At first, they challenged whether it was appropriate to offer company stock in a unitized stock fund. That was the thesis of their disclosed expert witness, the late Ross Miller. But for sound reasons, unitized funds are the dominant method for offering exposure to company stock in a 401(k) plan. Plaintiffs have now affirmatively disavowed that claim. In any event, the decision to unitize the company stock funds was made as a matter of plan design (and not as a fiduciary matter) prior to the limitations period, and is consistent with industry standards.

Second, Plaintiffs have contended that Defendants breached fiduciary duties by permitting plan participants to engage in a market-timing practice referred to as day trading. That claim is outside the class period—indeed, the class period is *defined* by the end of day trading. Moreover, the phenomenon of day trading that arose in the early 2000s was identified and addressed swiftly by Lockheed Martin. The problems posed by day trading were promptly identified and considered in February 2002 and, within six months, the plans had been amended, the recordkeeping system reprogrammed, new trading restrictions communicated to participants, and day trading effectively eliminated. In fact, Lockheed Martin was ahead of the curve in terms of its response to excessive participant trading. It was not until December 2003 that the Securities and Exchange Commission proposed rules to curb similar practices in mutual funds. And in February 2004, the Department of Labor advised plan fiduciaries that "investors generally could not anticipate the late trading and market-timing problems." Lockheed Martin's 2002 response reflected an appropriate response to that situation.

Finally, Plaintiffs have alleged that, even accepting that the company stock funds may be unitized and setting aside day trading, the funds retained excessive cash. To the contrary, the evidence will show that LMIMCo had a meticulous process in place for monitoring and assessing the liquidity levels in the funds. LMIMCo reviewed liquidity reports issued every three days and was in touch with the investment managers even more frequently when conditions warranted. The result was that Lockheed Martin's company stock funds had substantially *less* liquidity than industry standards. For all these reasons, Defendants are entitled to judgment.

FACTUAL BACKGROUND

A. Structure of the Plans

Plan participants in the Salaried Savings Plan ("SSP") and Hourly Employee Savings Plan Plus ("HSP") have access to three options for investing in Lockheed Martin company stock:

- Company Common Stock Fund (available in the SSP and the HSP)
- Employee Stock Ownership Plan ("ESOP") (available in the SSP) or Hourly ESOP (available in the HSP)
- Self-Managed Account ("SMA") (available in the SSP and the HSP, starting in 2001)

Company stock investments permit plan participants to share in the success of their employers. They are popular in 401(k) plans generally, and among Lockheed Martin participants in particular. Such investment options have been endorsed by Congress:

> The Congress, in a series of laws [including ERISA] has made clear its interest in encouraging [ESOPs] as a bold and innovative method of strengthening the free private enterprise system which will solve the dual problems of securing capital funds for necessary capital growth and of bringing about stock ownership by all corporate employees.

Fifth Third Bancorp v. Dudenhoeffer, 134 S. Ct. 2459, 2465-66 (2014) (quoting Tax Reform Act of 1976, § 803(h), 90 Stat. 1590).

In the Lockheed Martin plans, the Company Common Stock Fund and the ESOPs (collectively, the "company stock funds") were offered as unitized funds, which means that participants own units of a fund consisting primarily of company stock with a small cash buffer. Unitized funds are "industry standard for large 401(k)'s." *Tibble v. Edison Int'l*, 729 F.3d 1110, 1136 (9th Cir. 2013), *cert. granted on other grounds*, 135 S. Ct. 43 (2014) (No. 13-550). As of 2007, at least 10 of the 15 largest defined contribution plan sponsors offered unitized stock funds; and in 2008, two-thirds of plans of any size offering company stock options utilized unit accounting, with an average target cash reserve of 5%.

Thus, a typical company stock fund in 2008 would have targeted 95% stock and 5% cash. Only a target can be set because the actual liquidity level is influenced by participant trading activity. To demonstrate: A fund that starts the day with cash at its 5% target level must wait to see what plan participants do that day. At the end of the day, their purchases and sales are tallied and netted. If, for example, participants make net purchases equivalent to 1% of the fund's value, the plan will have an overnight balance of 6% cash. The investment manager will arrive the next morning and, when it determines market conditions to be appropriate, will purchase shares of stock in order to move the liquidity level to the 5% target.

Cash is needed in case participants want to sell their units in the company stock fund. Participants who sell units are entitled to a distribution from the plan in cash or a reinvestment of the proceeds in another plan investment option. Either way, cash is needed on-hand for those transactions (because it ordinarily takes three days to get cash when stock is sold). If there is insufficient liquidity, none of the transactions among the investment options can be processed, and the entire plan must be frozen until adequate liquidity can be generated.

The Company Common Stock Fund and the ESOPs were incorporated into the design of the SSP and the HSP when the predecessor plans from Lockheed Corporation and Martin Marietta Corporation were merged in 1997. Earlier in the 1990s, Martin Marietta moved from direct common stock ownership and once-a-month transaction processing to daily transaction processing. That transition necessitated liquidity, so Martin Marietta moved to a unitized company stock fund. Lockheed Corporation, on the other hand, still had direct stock ownership in its ESOP with a quarterly accounting schedule, meaning that plan participants could direct fiduciaries to reinvest their assets once each quarter. That transaction would be completed at some point during the following quarter. No liquidity is needed in a quarterly trading environment, although such an environment is considered antiquated by today's standards.

After the merger created Lockheed Martin, the company decided to offer daily transactions among all its 401(k) investment options and determined that all investment funds would therefore need to be unitized. That decision was made by the Corporation as plan sponsor when it created the plans.

The unitized nature of the company stock funds was repeatedly explained to plan participants in summary plan descriptions and other disclosures. This 2001 disclosure regarding the Company Common Stock Fund is typical:

> The Fund is invested primarily in Lockheed Martin common stock. However, a small portion of the Fund's assets are held in cash equivalent reserves to allow for the daily processing of fund transfers (reallocations and spot transfers) and withdrawals. Cash equivalent reserves typically range between 3% and 6% of the Fund. . . . Because the Company Common Stock Fund also invests in cash equivalent reserves, performance may vary from Lockheed Martin common stock.

One of the benefits of a unitized fund is that the fund need not buy shares on Monday if it expects to sell them again on Tuesday. Another benefit is that the number of stocktransactions,which can be processed at wholesale rates, are reduced by offsetting participant purchases and sales every day. Without unitization, there would have to be a market transaction every time a plan participant reallocated assets to or from the unitized company stock fund.

Starting in 2001, participants also could invest directly in Lockheed Martin stock through the Self-Managed Account ("SMA"). The costs of those transactions (which are processed at retail rates and are not offset by other participants' trades) are borne by the individual plan participants. *Cf. Loomis v. Exelon Corp.*, 658 F.3d 667, 672 (7th Cir. 2011) ("retail transactions occur at retail prices"). The SMA option is available to participants who prefer direct access to Lockheed Martin stock and who want to avoid pooling their assets in a unitized fund.

B. Administration of the Company Stock Funds

As the plans' investment fiduciary, LMIMCo was responsible for hiring an investment manager for the company stock funds, providing the investment manager with directions, and monitoring its performance. LMIMCo selected as the investment manager State Street Global Advisors ("SSgA"), the industry leader in company stock fund management. It was SSgA's responsibility to monitor participant trading activity and market activity for Lockheed Martin common stock, and to make appropriate market transactions consistent with the investment management agreement and fund policy statements issued by LMIMCo.

Consistent with industry norms, LMIMCo initially targeted a 3-5% liquidity rate for the Company Common Stock Fund and a 1-3% liquidity rate for the ESOPs, which contained frozen assets that reduced the frequency of participant activity. LMIMCo monitored actual liquidity rates through reports issued by SSgA every three days. Until February 2002, the liquidity needs of the unitized funds were consistent with industry norms and expectations.

That changed in early 2002. At that time, the company stock funds began to experience large daily swings in trading volume, both sales and purchases. The problem was identified and diagnosed almost immediately—the cause was certain plan participants who were engaging in active day trading. Participants began using technical metrics like moving averages to project overnight stock-price trends, entering daily trades that moved large sums into and out of the company stock funds at the end of each trading day.

LMIMCo personnel identified this issue in February, and the Investment Committee formally discussed the issue on March 18, 2002. By April 9, the Investment Committee received and reviewed a presentation from SSgA relating to the impact of liquidity levels and approved additional mechanisms for providing emergency liquidity. On April 28, the Committee again discussed the day trading situation and aggressive fixes that could not be accomplished directly by LMIMCo (as fiduciary) but that could be implemented only by Lockheed Martin (as plan sponsor). On May 6, LMIMCo's CEO, Anthony Van Schaick, updated the Investment Committee as to the Corporation's deliberations on the design of the plan. Meanwhile, Lockheed Martin was working with CitiStreet to develop the programming language to implement the expected amendment to the plans' written instruments that would restrict excessive participant trading in the company stock funds. On July 26, the Corporation amended the formal plan documents to prohibit plan participants from making purchases in the Company Common Stock Fund or in the ESOPs within thirty days of withdrawing assets from those funds. The change was effective August 1, 2002, for the SSP, and September 1, 2002, for the HSP, and notices were sent to plan participants.

The class period here begins when those trading restrictions were implemented. With the new trading restrictions in place, trading volume quickly decreased, target liquidity levels were achieved, and the amount of cash in the company stock funds was reduced. Additional trading restrictions were implemented in August 2003 (limiting the total number of trades in any fund) and January 2007 (extending the 30-day roundtrip prohibition to all funds). Each change required an amendment to the plan document by the corporate plan sponsor.

ARGUMENT

I. Plaintiffs Cannot Demonstrate A Breach Of Fiduciary Duty Based On The Corporation's Decision To Offer Company Stock Through A Unitized Fund.

Plaintiffs cannot establish a breach of fiduciary duty arising from the decision to offer (or to continue to offer) the Company Common Stock Fund and the ESOPs as unitized stock funds.

As an initial matter, Plaintiffs have waived any such argument. In the hearing on summary judgment, Plaintiffs represented to this Court that "these issues have gotten narrowed":

> We're not saying, so it is clear, that having a Unitized Stock Fund is necessarily imprudent. You don't need to decide that in this case. There are Plans that have them, Plans that don't have them. But what we're saying is that the management of this Company Stock Fund was imprudent . . . .

Doc. 199 at 38. Later in the same hearing, Plaintiffs reiterated the limitation on their claim:

> I want to go to the Company Stock Fund, Your Honor, and discuss some things on that. Again, we're not challenging the existence. This has been narrowed down. We're challenging the management of the Company Stock Fund.

Id. at 50. Plaintiffs cannot now litigate the claim they have expressly withdrawn.

There can be no breach of fiduciary duty with respect to the decision to offer company stock as a unitized fund because this structural determination was not the fiduciaries' decision to make. In every ERISA fiduciary action, there is a threshold question—whether the defendant was acting as a fiduciary or as the plan sponsor in making a particular decision. *Pegram v. Herdrich*, 530 U.S. 211, 225 (2000). "[A]n employer's decisions about the content of a plan are not themselves fiduciary acts." *Id.* at 226; *see also King v. Nat'l Human Res. Comm., Inc.*, 218 F.3d 719, 723 (7th Cir. 2000) ("[T]he defined functions of a fiduciary do not include plan design."). Here, the decision to offer company stock through a unitized fund was made by the plan sponsor and incorporated into the written instrument governing the plans. In such a circumstance, there is no fiduciary duty that could be breached. *See Lockheed Corp. v. Spink*, 517 U.S. 882, 887, 890 (1996); *Pegram*, 530 U.S. at 223, 226; 29 U.S.C. § 1002(21)(A).

In any event, even if the decision to offer company stock as a unitized fund were reviewed as a fiduciary decision, defendants are entitled to judgment. The decision to adopt a unitized fund was made prior to the limitations period and was an appropriate decision on the merits. In *George v. Kraft Foods Global, Inc.*, 641 F.3d 786 (7th Cir. 2011), the Seventh Circuit held that, when plan fiduciaries make a decision about whether to offer company stock as a unitized fund that involves "'balancing competing interests under conditions of uncertainty,'" "the question will be whether the fiduciaries abused their discretion." *Id.* at 797 (quoting *Armstrong v. LaSalle Bank Nat'l Ass'n*, 446 F.3d 728, 734 (7th Cir. 2006)). The evidence will show that the decisionmakers were aware of the different options for offering company stock—indeed, in merging the predecessor plans, plan fiduciaries were required to decide among the various options. They balanced the competing considerations to select a unitized fund. The choice they made was appropriate and well within their discretion. Indeed, unitization is the dominant choice within sophisticated 401(k) plans. There can be no liability for Lockheed Martin's decision to offer a unitized stock fund. *See also Tibble v. Edison Int'l*, 639 F. Supp. 2d 1074, 1118-19 (C.D. Cal. 2009) (granting summary judgment to defendants on claim that 401(k) plan should not have offered unitized stock fund, because cash levels were monitored by plan fiduciaries), *aff'd*, 729 F.3d at 1136-37.

II. Plaintiffs Cannot Identify A Breach Of Fiduciary Duty Based On Day Trading.

Nor can Plaintiffs identify a breach of fiduciary duty premised on day trading within the company stock funds. Any such claim is plainly outside the class period. As this Court has repeatedly ruled (Docs. 239, 367, 403), Plaintiffs' day-trading claim advances the interests of those who prefer a buy-and-hold strategy, contrary to the interests of those who prefer to engage in more frequent transactions, creating an intraclass conflict.

This Court set August 1, 2002, as the start of the class period on the assumption that day trading ceased on that date. The Court further acknowledged that, if the evidence were to establish day trading after August 1, 2002, it would be necessary to alter the class period to exclude any day-trading claim. Doc. 367 at 26. In short, day trading cannot form the basis for Plaintiffs' class claim.

Any day-trading claim can therefore proceed only on behalf of the individual named plaintiffs, who can pursue only damages personal to them. (This Court has also rejected Plaintiffs' assertion that they can pursue plan-wide damages without satisfying Rule 23.) Doc. 283.)

Defendants are entitled to judgment on the individual Plaintiffs' day-trading claim. As a threshold matter, the existence of trading restrictions is a matter of plan design. The trading restrictions here were implemented by the Corporation as an amendment to the written instruments governing the plans. Moreover, plan fiduciaries understood the Corporation's involvement to be required. That interpretation of the plan's terms is entitled to deference under the Supreme Court's rule in *Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101 (1989), because plan fiduciaries' interpretation of the plan was not an abuse of discretion.

In any event, even if evaluated as a fiduciary decision, Defendants' response to day trading was swift and effective. *See* Doc. 226 at 21. The problem was first detected in February 2002. The evidence will demonstrate that, within one month, the Investment Committee was engaged in substantive discussions about how to shore up the company stock funds and how to permanently curb market timing activity. In April, additional solutions were debated in additional meetings. By May, the Corporation considered proposals for amending the plans' written instruments. Amending the plan would also require reprogramming the recordkeeping system and providing plan disclosures for participants, so Lockheed Martin and LMIMCo personnel formed a task force to expedite all necessary processes. On July 26, 2002, the necessary legwork had been completed. The SSP was amended, effective August 1, the HSP effective September 1. As of that date, any plan participant who sold units from the company stock funds had to wait 30 days before repurchasing units in those funds. Day trading was no longer possible.

The problem of market timing was not unique to Lockheed Martin, but Lockheed Martin's response was considerably ahead of the curve. Market timing became a substantial problem in mutual funds, but the SEC did not formulate a proposed rule to tighten trading restrictions until December 2003. In February 2004, the Department of Labor issued guidance regarding fiduciary obligations as to market timing in mutual funds. At that time, DOL acknowledged that market timing was not a concern that should have been anticipated before it arose. In fact, as of 2005, only 15% of ERISA plans had policies to restrict the frequency of trades.

ERISA does not impose on fiduciaries a duty of prescience. It requires only prudence. Like everyone else in the marketplace and the government, Defendants did not foresee day trading or the effects it would have on the company stock funds, but they reacted to that phenomenon as one would hope fiduciaries would react. They discovered the problem through careful monitoring, promptly considered various responses, and implemented the chosen solution with dispatch.

III. Plaintiffs Cannot Identify A Breach Of Fiduciary Duty Based On The Administration Of The Liquidity Level.

Finally, Defendants are entitled to judgment on Plaintiffs' class claim regarding the administration of the company stock funds.

LMIMCo's conduct in monitoring and administering the company stock funds exemplified fiduciary prudence. Fiduciaries received and reviewed reports on liquidity levels every three days. They frequently reviewed liquidity targets and assessed the funds' preparation for contingencies. During the class period, they set target liquidity levels that were well below industry standards and monitored the investment manager to make sure that their instructions were followed.

At summary judgment, the Court found there to be a "genuine issue of material fact" "as to whether a breach of fiduciary duty occurred when cash equivalent reserves exceeded not only the typical range of 1% to 3% of the Fund but actually exceeded the 10% ceiling established in the April 4, 2004, prospectus." Doc. 226 at 21. The evidence will show that there were *no* occasions during the class period (or at any other time when the threshold was in place) when cash levels exceeded the 10% ceiling. Rather, the evidence will show that the target liquidity levels were set after thoughtful consideration and that LMIMCo properly monitored SSgA's compliance with its investment directives.

Plaintiffs' own expert reports corroborate the appropriateness of the management of the company stock funds. The late Ross Miller compared the performance of the company stock funds to the performance of Lockheed Martin common stock. But that comparative analysis is fundamentally flawed. It would have been impossible for plan participants to achieve the hypothetical performance of common stock even with direct stock ownership because the historical stock performance does not account for the transaction costs of buying and selling shares (which would have occurred at least weekly for plan participants who allocated a portion of their payroll withholdings to the company stock funds) and does not account for the market impact of large transactions (which can move the price in an unfavorable direction). Moreover, the comparison to company stock performance assumes that the company stock funds could have been operated without any liquidity (contrary to Plaintiffs' later "narrowing" of their claim). In any event, even on that skewed metric, Dr. Miller determined that the Company Common Stock

Fund *outperformed* common stock during the class period. Steve Pomerantz, who has replaced Dr. Miller as Plaintiffs' expert on this issue, validated that analysis. And although they found that the ESOP funds slightly underperformed the same benchmark during the class period, that difference cannot be attributable to unsound cash management because the ESOPs kept a lower percentage of their assets in cash than the Company Common Stock Fund during the class period.

Plaintiffs have identified a scattering of other issues about the management of the company stock funds that are equally without merit. They have alleged that Lockheed Martin impermissibly delegated authority to SSgA so that SSgA could enhance its own management fees, supposedly because State Street was Lockheed Martin's biggest shareholder. But it was LMIMCo (not SSgA) that set the liquidity targets and LMIMCo (not SSgA) that monitored SSgA's compliance with those targets. Moreover, State Street is not the largest shareholder of Lockheed Martin. It "owns" shares of Lockheed Martin stock as trustee over the company stock funds. That ownership is for the benefit of plan participants (rather than for its own profits).

* * *

Lockheed Martin's company stock funds were supervised by thoughtful plan fiduciaries who were mindful of participant interests and dedicated to providing appropriate investment options to those participants who wanted exposure to company stock. That management exemplified procedural and substantive prudence and was well within the discretion afforded to expert fiduciaries.

CONCLUSION

At the close of the evidence, this Court should enter judgment for Defendants on Plaintiffs' company stock claim.

Dated: December 3, 2014

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CERTIFICATE OF SERVICE

The undersigned, one of the attorneys for Defendants Lockheed Martin Corporation and Lockheed Martin Investment Management Company, hereby certifies that on the 3rd day of December 2014, a true and correct copy of the foregoing was electronically filed with the Clerk of the Court using the CM/ECF system, which will send notification of such filing to the following:

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