

ERISA: ESOP Fiduciaries Are Not Entitled to a "Presumption of Prudence"

7/8/2014

Practices: Employment, Labor & Benefits

Last week, in one of its final opinions of the term, the Supreme Court of the United States (the "Court") held that ESOP fiduciary decisions to buy or hold employer stock are not entitled to a "presumption of prudence" standard as several lower federal courts have held. Instead, except for the need to diversify assets, the Court held that ESOP fiduciaries are subject to the same fiduciary standards that apply to all ERISA plan fiduciaries. *Fifth Third Bancorp v. Dudenhoeffer*, No. 12-751, decided June 25, 2014.

Fifth Third Bancorp (the "Petitioners") sponsored a defined contribution savings plan that permitted participants to invest in 20 separate funds, including mutual funds and an ESOP. The plan required that the ESOP be "invested primarily in shares of common stock of Fifth Third." In this case, Fifth Third employees and ESOP participants filed a putative class action in federal court claiming that Fifth Third and various Fifth Third officers were plan fiduciaries who violated their duties of loyalty and prudence imposed by ERISA. Specifically, the class alleged that the plan fiduciaries *knew or should have known* that the Fifth Third stock was overvalued and risky because of both public information and non-public information available to them. When the market fell, the Fifth Third stock price fell "74% between July 2007 and September 2009," eliminating the retirement savings of many.

As a starting point, ERISA requires a plan fiduciary to, in pertinent part, "discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and (A) for the exclusive purpose of (i) providing benefits to participants and the beneficiaries; and (ii) defraying reasonable expenses of the plan; (B) with the care, skill prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims; (C) by diversifying the investments of the plan to minimize the risk of large losses . . . (D) in accordance with the documents . . . governing the plan . . ."

In reviewing several arguments presented by Fifth Third Bancorp to advance the "presumption of prudence" standard, the Court noted that the Petitioners "are basically seeking relief for what they believe are meritless, economically burdensome lawsuits," and then the Court reviewed "one important mechanism", the motion to dismiss for failure to state a claim. In the case at bar, the District Court dismissed the complaint for failure to state a claim upon which relief could be granted because it found that the Petitioners could not overcome the

presumption of prudence. In contrast, the Court of Appeals held that no presumption of prudence should apply and that the respondents had "stated a plausible duty-of-prudence claim."

With regards to the allegations that that Fifth Third and various Fifth Third officers knew or should have known based on publically available information (newspapers, stock market) that continuing to purchase or hold Fifth Third stock was imprudent because the stock price was declining in value, the Court stated that, "where a stock is publically traded, allegations that a fiduciary should have recognized from publically available information alone that the market was over-or undervaluing the stock are implausible as a general rule." Generally, it "is not imprudent to assume that a major stock market . . . provides the best estimate of the value of the stocks traded on it . . ."

With regards to the allegations that that Fifth Third and various Fifth Third officers acted imprudently because they failed to act based on "insider information" known because of their positions within the company, the Court noted that ERISA does not require a fiduciary to "break the law," by "performing an action – such as divesting the fund's holdings of employer stock on the basis of inside information – that would violate securities laws." In addition, because the complaint included allegations that that Fifth Third and its officers failed "to decide, on the basis of inside information, to refrain from making additional stock purchases or for failing to disclose information to the public so that the stock would no longer be overvalued, the Court indicated that the lower courts should consider how an ERISA-based obligation might conflict with federal securities laws.