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Labor and Employment Alert: In Dudenhoeffer, Supreme Court Takes a Bite Out of the Moench Presumption of Prudence

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Jennifer Bibart Dunsizer

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In a unanimous decision that was a surprise to most in the benefits community, the Supreme Court, in *Fifth Third Bancorp v. Dudenhoeffer*, rejected the commonly accepted rule that fiduciaries of employee stock ownership plans (ESOPs) are entitled to a “presumption of prudence” in connection with their decision to buy or hold employer stock.

Under the Fifth Third ESOP, participants made contributions into an individual account and directed the ESOP to invest those contributions in a menu of options pre-selected by Fifth Third, one of which was the Fifth Third stock fund. The matching contributions were made in Fifth Third stock, although all participants could subsequently move such contributions to other investment options.

As a result of the downturn in the economy, due in part to the housing crisis, Fifth Third’s stock price fell by 74% between July 2007 and September 2009. Plaintiffs commenced a class action lawsuit, alleging, among other things, that the Fifth Third ESOP’s fiduciaries breached their fiduciary duties under ERISA by: (i) imprudently maintaining significant investment in Fifth Third stock and continuing to offer it as an authorized investment option; and (ii) by failing to provide participants in the Fifth Third ESOP with accurate and complete information about Fifth Third and the risks of investment in Fifth Third stock.

No more presumption of prudence

Although a number of courts of appeals had adopted a “presumption of prudence” standard, the Supreme Court has now ruled that there is no such presumption. The Supreme Court noted that all ESOP fiduciaries are subject to the “prudent man standard of care,” and that although ESOP fiduciaries are not subject to the requirement that plan assets be diversified, there is no special presumption protecting ESOP fiduciaries. Under the new standard adopted by the Supreme Court, each stock-drop claim requires a case-by-case scrutiny of the plaintiff’s allegations without a presumption that the fiduciary’s actions were

prudent.

This leaves ESOP fiduciaries in the uncomfortable position of having to predict the stock market when the stock price is falling; should the fiduciary stop buying more shares, or even sell the shares held by the plan to avoid further losses, and risk missing the gains when the stock market turns, or should the fiduciary continue to follow the plan document.

New presumption for plans holding publicly traded employer stock

The Supreme Court has adopted a presumption for plans holding publicly traded employer stock. An allegation based on **publicly available information** that plan fiduciaries should have recognized that the market was overvaluing or undervaluing the stock is “implausible as a general rule” and thus will be insufficient to state a claim.

The Supreme Court also ruled that the duty of prudence does not require plan fiduciaries to violate federal securities law. Thus, where the complaint alleges that the plan fiduciaries acted imprudently by failing to act on the basis of **nonpublicly available information**, the allegation must also allege a prudent alternate course of action that would not violate other laws.

New standard for all plans holding employer stock

The Supreme Court directed lower courts to consider whether the complaint has plausibly alleged that a prudent fiduciary could not have concluded ceasing to purchase employer stock or publicly disclosing negative information would do more harm than good to the ESOP by causing a drop in the price of the stock.

The combination of these provides some protection for fiduciaries facing a claim that they should have either sold the shares before informing the public (which would violate federal securities law) or should have told the public earlier (which may have done more harm than good).

Although the Court found that there is no statutory basis for a “presumption of prudence” standard with regard to an ESOP fiduciary’s decision to hold or purchase employer stock, the Court set forth clear and somewhat more difficult standards for lower courts to apply in reviewing such claims in the motion to dismiss stage. One of the issues that is expected to unfold is the extent to which the Court’s decision not to recognize a presumption may cause plaintiffs’ cases to withstand dismissal at early stages of litigation, thereby adding to litigation costs and possibly increasing the likelihood of settlement.

Employers whose plans hold employer stock will want to consider the implications of this decision on that stock holding. The landscape has shifted.