Supreme Court Strikes Down Presumption of Prudence For Fiduciaries Investing in Employer Securities

On June 25, 2014, the Supreme Court in *Fifth Third Bancorp v. Dudenhoeffer* unanimously held that no special presumption of prudence applies under ERISA for investments in employer stock. The case involved a form of employee stock ownership plan (ESOP) but has relevance for all individual-account plans that include employer stock as an investment option.

ERISA requires plan fiduciaries to act with prudence. It also requires diversification of plan investments, with some exceptions. ESOPs and other individual-account plans with employer stock funds would violate the diversification requirement itself, and the prudence rule insofar as it requires diversification, but for a statutory exemption that gives relief on both fronts. The statutory exemption does not relieve fiduciaries of the need to consider non-diversification aspects of prudence, however. Most lower courts before *Dudenhoeffer* made sense of this residual duty of prudence by holding that plan fiduciaries investing eligible individual account plan assets in employer stock should be presumed to have acted prudently, although the presumption could be overcome in extreme circumstances (*e.g.*, imminent financial collapse). The Supreme Court has now held otherwise.

Background

The facts of *Dudenhoeffer* are similar to the facts of many other so-called "stock drop" cases. Fifth Third Bancorp maintained a defined contribution retirement savings plan under which employees could choose to invest in up to twenty funds, including the Fifth Third stock. Between July 2007 and September 2009, Fifth Third's stock price fell by 74%. In September 2009, ESOP participants brought suit, claiming that the fiduciaries to the plan violated the ERISA duties of loyalty and prudence by remaining invested in and continuing to purchase the stock of Fifth Third.

The district court dismissed the complaint for failure to state a claim, finding that the fiduciaries were entitled to a presumption that investing in employer securities was prudent and that a plaintiff was required to allege an abuse of discretion by the fiduciaries in the face of dire circumstances. On appeal, the Sixth Circuit agreed that fiduciaries were entitled to a rebuttable presumption of prudence, but held that the presumption applied at the evidentiary stage rather than the pleading stage.

The presumption of prudence

In reaching its decision, the district court relied on nearly twenty years of judicial precedent applying a presumption of prudence. The line of cases stems from the 1995 decision in *Moench v. Robertson*, in which the Third Circuit, looking to principles of trust law to interpret ERISA, held that when a fiduciary is instructed to invest in employer securities, the fiduciary's decision to do so should be reviewed for an abuse of discretion, rather than *de novo*.

In contrast, the Supreme Court in *Dudenhoeffer* found that the prudence standard for ESOPs is no different than the standard for other plans. While the Court recognized that Congress has favored ESOPs and has exempted them from the duty to diversify, it found that this relief from diversification does not result in an otherwise narrower duty of prudence.

Many ERISA individual-account plans (*e.g.*, 401(k) plans), and not only ESOPs, offer an undiversified employer stock fund as one of several funds available to participants. While the facts of *Dudenhoeffer* involved an ESOP, its logic applies with equal force to other individual-account plans investing in employer stock.

Without a presumption of prudence for investments in employer stock, plan fiduciaries may be left in a very difficult position. ERISA requires fiduciaries to follow plan documents to the extent those documents are consistent with ERISA. Thus, a failure to follow plan documents is itself a breach of fiduciary duty unless the documents violate ERISA. Where a plan provision requires a fiduciary to invest in employer stock and the investment is arguably but not indisputably imprudent, participants with the benefit of hindsight may sue the fiduciary either for continuing to invest in the stock (if the stock falls in value) or for selling the stock in violation of plan terms (if it does not). The Supreme Court recognized this difficulty but held that a presumption of prudence is not the appropriate solution and that ERISA requires courts to engage in "careful, context-sensitive scrutiny of a complainant's allegations."

The court did provide solace to plan fiduciaries in one key area. Not infrequently, officers of public companies maintaining an ESOP or similar plan may serve as fiduciaries with respect to the company's plans. Investment decisions affecting a plan's employer stock fund may create tension with the fiduciary's obligations under the securities laws. The Supreme Court in *Dudenhoffer* rejected the contention that ERISA requires a fiduciary to act in violation of other laws. It left for the lower courts to determine what duties and choices an ERISA fiduciary *does* have when faced with the difficulty of dealing prudently with an employer stock fund.

Implications for plan sponsors and fiduciaries

It is too early to know with certainty how *Dudenhoeffer* will affect plan designs or employer-stock-fund litigation. The Supreme Court's opinion makes it clear that plaintiffs claiming a breach of fiduciary duty must plead sufficient facts to show that a claim is plausible. An improperly pleaded complaint may still be subject to dismissal, even without a presumption of prudence. However, plaintiffs able to present plausible (if unproven) grounds for relief will no longer face the defense that challenged conduct by a fiduciary under an ESOP or similar plan is protected by a presumption of prudence.