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Summary of Supreme Court Decision
Fifth Third Bancorp et al. v. Dudenhoeffer et al.

On June 25, 2014, the Supreme Court issued an opinion that in critical ways is very favorable for employer plan sponsors and ERISA plan fiduciaries. The issue in *Fifth Third Bancorp et al. v. Dudenhoeffer et al.* was the standard applicable in determining whether it is prudent for an ESOP fiduciary to buy or hold employer stock. The Court started by holding that there is no presumption that buying or holding employer stock is prudent, which is an adverse holding. But the Court went on to state that, in the absence of special circumstances, claims that a fiduciary should have recognized, based solely on public information, that the market was overvaluing the stock of a public company are "implausible."

Thus, the Court's critical holding is that a complaint alleging that it was imprudent for a fiduciary to hold or purchase publicly traded employer stock cannot survive at the pleadings stage in the absence of plausible allegations of special circumstances. This will be extremely helpful in screening out baseless stock drop suits. This holding could also be an aid in other types of claims of imprudence regarding investments that are publicly traded. The case does not, however, address, or relate as easily to, non-publicly traded investments, or to cases involving investment management fees and the fiduciary duty of prudence.

Background

Following the financial crisis in 2008, courts experienced increased stock-drop cases involving allegations that ESOP fiduciaries violated their fiduciary duty of prudence under ERISA by not selling employer stock before the value of the stock decreased. In deciding these cases, appellate courts held that ESOP fiduciaries were entitled to a "presumption of prudence" in determining whether to hold or buy employer stock. Courts developed the presumption of prudence to resolve the policy "tension" in ERISA between protecting plan participants against imprudent plan investments and adhering to ERISA's aim of favoring employee stock ownership.

Section 404(a) of ERISA requires that fiduciaries act with a prudent standard of care, which includes the duty to diversify plan investments so as to minimize the risk of large losses. At the same time, ERISA recognizes the value of employee stock ownership, and as a result, exempts the acquisition or holding of employer stock from ERISA's diversification requirement.

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Allegations. Respondents were former employees of Petitioner Fifth Third Bancorp, and participants in the bank's defined contribution plan (the "Plan"), which permitted participants to invest in two collective funds, seventeen mutual funds, and Fifth Third stock, which was publicly traded. The Fifth Third stock fund constituted an ESOP.

Respondents alleged that by July 2007, Plan fiduciaries knew that the bank's stock was a risky investment due to the bank's investments in subprime loans. Respondents further alleged that fiduciaries violated their duty of prudence under ERISA by acquiring additional stock, not

selling current holdings of the stock, and failing to act on or disclose inside information about the stock, before its price plummeted 74 percent.

No presumption of prudence. In its decision, the Supreme Court acknowledged the "tension" in ERISA that lower courts attempted to reconcile with a presumption of prudence, but found that the only exception the statute provides to ESOP fiduciaries with respect to the duty of prudence is the exception from the duty to diversify. The Court noted that the statutory language of ERISA overrides any provision in a plan document, or any theory under the common law of trusts, that attempts to provide a fiduciary with a presumption of prudence with respect to the holding or purchasing of employer stock.

Determining whether a plaintiff has stated a plausible claim that can survive the pleadings stage. Even without a presumption of prudence, plaintiffs must present plausible allegations. The Court explained that whether a plaintiff states a plausible claim for a fiduciary breach of prudence depends on the specific circumstances. The Court then went on to explain that the analysis of whether a claim is plausible requires two separate analyses based on whether plaintiffs allege that defendants should have acted on public or non-public information.

First, the Court stated that generally it is "implausible" for plaintiffs to allege that a fiduciary should have recognized, based solely on public information, that the market was overvaluing or undervaluing the stock of a public company. The Court reasoned that the market price is set based on publicly available information. The Court noted, however, that there may be "special circumstances" where public information could undercut the reliability of the market price, and in those instances plaintiffs may be able to state a plausible claim. The Court declined to speculate what "special circumstances," if any, could give rise to a claim.

The Court offered some, albeit not much more, flexibility for plaintiffs who allege that plan fiduciaries violated their fiduciary duty of prudence by not acting on insider information with respect to publicly traded stock. In this instance, the Court proffered a new standard. Specifically, to state a fiduciary breach claim alleging fiduciaries should have acted on insider information, plaintiffs must "plausibly allege an alternative action that the defendant could have taken that would have been consistent with securities laws and that a prudent fiduciary in the same circumstances would not have viewed as more likely to harm the [plan] than to help it."

The Court stated that lower courts should "inform" their analysis by considering whether imposing ERISA liability on the basis of insider information could conflict with federal securities laws, and reminding courts that fiduciaries do not breach their duty of prudence by complying with federal laws. In addition, the Court requested that lower courts consider whether a fiduciary with insider information may do more harm to the stock price by acting on or releasing that information.