To read the decision in *Fifth Third Bancorp v. Dudenhoeffer*, please click here.

The Supreme Court Clarifies Pleading Standards for ERISA Breach of Duty of Prudence Claims Against ESOP Fiduciaries

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Today, the Supreme Court clarified the requirements for pleading an Employee Retirement Income Security Act (ERISA) breach of the duty of prudence claim involving Employee Stock Ownership Plans (ESOPs), employee benefit plans that invest primarily in employer stock. The Court concluded, in a unanimous opinion, that ESOP fiduciaries are not entitled to a special presumption of prudence. At the same time, however, the Court articulated alternative defenses that defendants can assert in response to ERISA stock drop cases, including, for example, that a complaint fails to plausibly allege a legal alternative action that the defendant could have taken that a prudent fiduciary in the same circumstances would not have viewed as more likely to harm than to help. The Court also held that allegations that defendants should have sold based on publicly available information are generally insufficient to state a claim. Moreover, ERISA does not require a fiduciary to break the law by acting on non-public or inside information.

BACKGROUND

Defendant Fifth Third, a financial services company, sponsored a 401(k) defined contribution plan. Eligible Fifth Third employees were permitted to make voluntary contributions to the plan and direct them to any of the plan's investment options. The plan required that one investment option offered to plan participants be the Fifth Third Stock Fund, which was an ESOP.

Plaintiffs alleged that Fifth Third and plan fiduciaries violated their fiduciary duties under ERISA by continuing to offer the Fifth Third Stock Fund after it had purportedly become an imprudent investment. The Southern District of Ohio dismissed the complaint, holding that the fiduciaries were entitled to a presumption of prudence with respect to their decision to include the employer stock fund as an investment option. The district court held that plaintiffs had failed to overcome the presumption because they had not plead facts showing that the company was in a dire financial predicament.

The Sixth Circuit reversed, holding that the presumption of prudence did not apply at the pleading stage. The court held that the presumption was an evidentiary standard and not a standard of review, and would apply at summary judgment. The Sixth Circuit's holding differed from the standards in the Second, Third, Fifth, Seventh, and Eleventh Circuits, all of which have held that the presumption of prudence applies at the pleading stage.

"[T]he law does not create a special presumption"

-Justice Breyer

"[W]here a stock is publicly traded, allegations that a fiduciary should have recognized from publicly available information alone that the market was over- or undervaluing the stock are implausible as a general rule, at least in the absence of special circumstances."

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ERISA "does not require a fiduciary to break the law"

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SUMMARY OF THE DECISION

Justice Breyer wrote the opinion for a unanimous Court. In holding that ESOP fiduciaries were not entitled to a special presumption of prudence, the Court looked to the language of ERISA. The Court stated that its conclusion that "the law does not create a special presumption" "follows from the pertinent provisions of ERISA," and cited Section 1104, which discusses the duty of prudence. The Court noted that Section 1104 "establishes the extent to which [the duty of prudence is] loosened in the ESOP context to ensure that employers are permitted and encouraged to offer ESOPS." The Court further explained that Section 1104 "makes no reference to a 'special presumption' in favor of ESOP fiduciaries." Rather, the only modification permitted under ERISA for ESOP fiduciaries is an exemption from ERISA's diversification requirement (*i.e.* ESOPS can make undiversified investments in employer stock). The Court concluded: "Thus, ESOP fiduciaries, unlike ERISA fiduciaries generally, are not liable for losses that result from a failure to diversify. But aside from that distinction, because ESOP fiduciaries are ERISA fiduciaries and because §1104(a)(1)(B)'s duty of prudence applies to all ERISA fiduciaries, ESOP fiduciaries are subject to the duty of prudence just as other ERISA fiduciaries are."

The Court then clarified the requirements for pleading an ERISA breach of the duty of prudence claim. The Court noted that the Sixth Circuit had held that plaintiffs-respondents had stated a plausible duty of prudence claim. The Court vacated and remanded the Sixth Circuit's decision to apply the pleading standard as discussed in *Twombly* and *Iqbal* in light of the following considerations:

First, the Court held that "where a stock is publicly traded, allegations that a fiduciary should have recognized from publicly available information alone that the market was over-or undervaluing the stock are implausible as a general rule, at least in the absence of special circumstances." The Court held that ERISA fiduciaries who "could reasonably see 'little hope of outperforming the market . . . based solely on their analysis of publicly available information,' may, as a general matter, [] prudently rely on the market price."

Second, "to state a claim for breach of the duty of prudence on the basis of inside information, a plaintiff must plausibly allege an alternative action that the defendant could have taken that would have been consistent with the securities laws and that a prudent fiduciary in the same circumstances would not have viewed as more likely to harm the fund than to help it."

In conducting this analysis, courts should bear in mind the following: (1) ERISA "does not require a fiduciary to break the law," such as engaging in insider trading by divesting the fund's holdings based on inside information; (2) where a complaint alleges that a fiduciary, based on inside information, should have refrained from making additional stock purchases or disclosed the inside information to the public, courts should "consider the extent to which an ERISA-based obligation" to do so "could conflict with the complex insider trading and corporate disclosure requirements imposed by the federal securities laws or with the objectives of those laws"; and (3) "whether the complaint has plausibly alleged that a prudent fiduciary in the defendant's position could not have concluded that stopping purchases—which the market might take as a sign that insider fiduciaries viewed the employer's stock as a bad investment—or publicly disclosing negative information would do more harm than good to the fund by causing a drop in the stock price and a concomitant drop in the value of the stock already held by the fund."

IMPLICATIONS

The Supreme Court's decision reverses the precedent of the Second, Third, Fifth, Sixth, Seventh, Ninth, and Eleventh Circuits, which had all held that ESOP fiduciaries are entitled to a presumption of prudence. At the same time, the Court's holdings on pleading requirements for a breach of the duty of prudence claim provides clarity to the courts in addressing motions to dismiss going forward. In order to state a claim for breach of the duty of prudence based on inside information, plaintiffs must plausibly allege that the defendant could have taken an alternative action that would have been consistent with the securities laws and that a prudent fiduciary in the same circumstances would not have viewed as more likely to harm the fund than to help it. While defendants will no longer be entitled to rely on the presumption of prudence in ERISA stock drop cases, the Supreme Court has laid the framework for alternative defenses that defendants can assert in response to such cases.

For further information about this decision, please feel free to contact members of the Firm's Securities Litigation Department, including:

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